Australian Government
AusAID

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Vanuatu

Governance for Growth - Phase II

2012-2016

Program Design Document

Post Peer Review Edit, November 2012

Vanuatu
National capital
TORBA Province name
Province capital
Road
0 25 50 75 100 Kilometers
0 25 50 75 100 Miles
Mercator Projection
ÎLES TORRES
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TORBA
Vanua Lava
Sola
Mota
ÎLES BANKS
Santa Maria
Mérig
Méré Lava
SANMA
Espiritu Santo
Big Bay
Lathi
Port-Olry
Lataro
Mavéa
Luganville
Tutuba
Aoré
Malo
Bougainville Strait
Longana
Aoba
Naoné
Maéwo
Passage Patteson
Loltong
PENAMA
Pentecôte
SOUTH PACIFIC OCEAN
Lakatoro
Détroit de Selwyn
Malakula
MALAMPA
Lamap
Tomman
Eas
Ambrym
Liro
Paama
Lopévi
Ringdove
Épi
Coral Sea
Morua
Tongoa
Tongariki
Émaé
ÎLES SHEPHERD
Makura
Mataso
SHEFA
Nguna
Moso
Émao
Lélépa
Éfaté
Port-Vila
Forari
Vété Manung
Unpongkor
Ipota
Erromango
TAFEA
Aniwa
Tanna
Ireupuow
Isangel
Futuna
Anelghowhat
Anatom
Inyeug
FED. STATES OF MICRONESIA
MARSHALL ISLANDS
NORTH PACIFIC OCEAN
Equator
NAURU
KIRIBATI
PAPUA NEW GUINEA
SOLOMON ISLANDS
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Annexes

Abbreviations and Acronyms

ADB	Asian Development Bank
ANS	(AusAID's) Assessment of National Systems
A$ or AUD	Australian dollar
AusAID	Australian Agency for International Development
AVL	Airports Vanuatu Ltd
CRP	Comprehensive Reform Program (1997-2007, approx.)
DESP	(Former) Department of Economic and Sector Planning
DFAT	Australia's Department of Foreign Affairs and Trade
DoFT	Department of Finance & Treasury
FSB	Financial Service Bureau
GBE	Government Business Enterprise
GDP	Gross Domestic Product
GfG (I or II)	Governance for Growth Program (Phase I or Phase II)
GNI	Gross National Income
GoV	Government of Vanuatu
ICT	Information & Communication Technology
MDB	Multilateral Development Banks
MFEM	Ministry of Finance & Economic Management
MLNR	Ministry of Lands & Natural Resources
MoE	Ministry of Education
NBV	National Bank of Vanuatu
ODA	Official Development Assistance
ODE	AusAID's Office of Development Effectiveness
OGCIO	Office of the Government Chief Information Officer
PAA	Vanuatu's Priorities and Action Agenda, 2006-2015
PFM	Public Financial Management
PGS	Partner Government Systems
PLAS	Vanuatu's 'Plan Long Act Short' 2009-2012 action agenda
PMO	Prime Minister's Office
PSC	Public Service Commission
$	US dollar, unless otherwise specified
SME	Small and Medium-sized Enterprises
SOE	State-Owned Enterprise
TA	Technical Assistance
UAP	Universal Access Policy
VCMB	Vanuatu Commodities Marketing Board
VT or VUT	Vanuatu vatu
WIPS	Working in Partner Systems

Executive Summary

Design Context

The Governance for Growth program (GfG) was established in 2006/07, within the mandate of Vanuatu's 2006 Priorities and Action Agenda, to help generate economic growth and improve service delivery through good governance.

Critical to GfG's original design was a recognition of the need for a deeper partnership between donor and government, able to go beyond sectoral and technical fixes, to address more fundamental policy and institutional issues that shape the pace and quality of economic growth and poverty reduction.

GfG was established as an adviser, facilitator and broker of regulatory reform and improved public expenditure management, for the purposes of improving growth and service delivery. It was constructed as a platform for effective policy dialogue, supporting the analytical and consultative processes that inform policy formulation, as well as providing resources for policy implementation.

The 2006 design envisaged a ten-year implementation period, recognising the need for a long-term commitment to achieve and assess the impact of this different approach to development cooperation. The first five-year phase of GfG had an initial budget of A$33 million (although significant additional project funding was subsequently added for infrastructure projects), and is due to end later in 2012.

Analysis and Strategic Context

Economic growth is critical to poverty reduction and development in Vanuatu. The country's population of nearly a quarter of a million is expanding by 2.6 per cent per year. Nearly 13 per cent of the population live below the national poverty line. More significantly, the great majority of the population suffer from poverty of opportunity: a lack of access to reasonable quality education, health, basic transport and basic infrastructure.

Vanuatu is currently off-track to achieve MDGs 1, 3, 5 and 7.

While commentaries have noted reasonable absolute growth rates in Vanuatu recently, buoyed by tourism and construction, annual per capita growth rates over the longer term have been erratic. Per capita GDP growth has been below 2% in ten of the last 30 years, and has been trending downwards for much of that time.

Also critically important in the Vanuatu context, however, is the quality and equitability of the growth that is achieved. The economy remains highly dualistic, with the great majority of development in the urban areas of Port Vila and (to a lesser extent) Luganville. Yet three-quarters of Vanuatu's population is rural and, to a large extent, not yet fully participating in the formal—or even cash—economy.

Lessons learned from GfG Phase I

GfG has been widely praised for its relevance and utility by GoV, other stakeholders and through reviews and evaluations. It is credited with having provided pivotal *'right thing, right place, right time'* support to major policy and institutional reforms, including in the telecoms and power sectors, rural electrification, transport infrastructure improvements, fee-free education, and strengthening of public financial management.

GfG's success is attributed to:

- Its physical and operational accessibility—located not in the Australian High Commission but in a central Government of Vanuatu compound;
- The informality and approachability of its ways of working, its communication and interface with government staff, and its immersion in the real processes of policy-making;

- Its backing of GoV's own policy efforts and aspirations, while exercising discretion and adding value through support and advice;
- Its willingness to be entrepreneurial, strategically opportunistic and to some extent risk-taking (in a policy sense), while maintaining absolute integrity over AusAID funds and resources;
- Its commitment to support the full policy development cycle, from dialogue through to implementation;
- Its understanding of and sensitivity to the political economy of policy-making in Vanuatu;
- Its engagement with multiple stakeholders in economic policy and service delivery: central and decentralised units of government, other development agencies and the banks, the private sector, civil society;
- The seniority[1], credibility and delegated authority of its carefully selected AusAID leadership, working closely with the Head of Post;
- The quality and positioning of its mostly ni-Vanuatu staff in key positions;
- The trust that has been established and respected;
- The robustness and quality of its analysis and advice.

GfG's strength was also in its open and flexible mandate, providing for the 'strategic opportunism' that yielded some of its big wins. This was as right as it was innovative, and it got results.

Program Objectives

This design is for the second phase of a program that is already up and running, continues to be relevant and effective, and is highly regarded. Unsurprisingly therefore the design recommends few substantive changes. Indeed, this Phase II design reinforces the original design parameters and recommends that GfG divests itself of the more transactional program implementation work that was added to GfG's brief part-way through Phase I.

Purpose	**To generate economic growth and improve service delivery through good governance** GfG constitutes the principal vehicle for the Australia-Vanuatu Partnership for Development's 'Partnership Priority Outcome 4: Economic Governance'.
Result Area 1	**Vanuatu's policy framework is more supportive of durable, equitable and broad-based growth** *Better policy development* through better evidence, based on better analysis and better communication of policy options
Result Area 2	**The quality of Vanuatu's public expenditure and its management is improved** *Better policy implementation* through better public expenditure choices and better public expenditure management

GfG's primary role will continue to be that of a key facilitator, adviser and broker—where opportunity arises—of:

- Regulatory reform, for the purpose of generating meaningful, robust and equitable ('pro-poor') economic growth; and
- Improved public expenditure management to increase service delivery to those most in need.

[1] GfG is directed by a full-time '*Executive Level 2'* AusAID public servant.

GfG's principal tool is a small but capable and deeply-immersed permanent staff—including national staff with exceptional institutional experience and political savvy—who are able to engage in policy dialogue with the most senior levels of government on a daily basis, both formally and informally, and draw-in resources to support policy development as needed.

That support may take the form of internal or externally-commissioned research and analysis, short- and medium-term advisory and legal inputs, support for policy development processes such as stakeholder consultations and briefings, short- and medium-term capacity building, and pilot projects.

Importantly GfG must provide the resources to see policy development and institutional reform through to implementation. This may come from AusAID (drawn from GfG's own immediately accessible 'Flexible Fund' or—in the longer-term—the wider AusAID bilateral program pipeline). But GfG should also play the role of broker or intermediary, drawing in resources from others, typically, the multilateral development banks (MDBs), other bilateral donors or the private sector, where it is appropriate.

GfG should continue to test innovative forms of aid in pursuit of its objectives. Performance-linked aid instruments have had a particular role in some of GfG's most successful work.

In Phase II the functions of GfG will focus on:

- Improving public expenditure management, particularly downstream beyond the central ministries to decentralised units of government.
    - Following generally successful reform and strengthening of central ministries' budget and public financial management systems, the challenge now is to extend this capability to those parts of government that are using those resources to deliver services to citizens.
- Increasing connectivity between emerging macroeconomic issues and development strategy, including balancing the [principally GoV-funded] recurrent budget and the [principally donor-funded] capital budget.
    - Core activities will be to provide the macroeconomic analysis and modelling to support a multi-year fiscal strategy that better integrates capital and current expenditure. This should include, among other things, analysis and advice on the macroeconomic and distributional implications of the flow of resources from donors.
- Progressing economic reform to support a more dynamic, resilient and pro-poor economy and development trajectory. This will include consolidating past reforms, which are still bedding down, and facilitating sound, new reforms where there is policy space and where it supports the objectives of the Vanuatu-Australia Partnership for Development.

Primarily, the work program for GFG will be driven by demand from Government for support for reform. So, the discrete Phase II activities for GFG, by and large, cannot be prescribed in this design. Nor can the program's areas of focus be limited to specific sub-sectors. This is in keeping with the principles of agility and flexibility which have been among GfG's key strengths. In phase II GfG will be defined by its role and function, not by the things it does or the sectors in which it operates.

What does success look like?

Economic growth and development outcomes are not just the consequence of technical economic policy settings. They are the result of economic, social, political and institutional forces that determine the availability of resources, their deployment, their transformation into public and private goods and services, and productivity improvements over time.

What success looks like for GfG, and how much can be attributed to GfG's support, needs to reflect that reality. Phase II outcomes and impacts are defined at three levels:

I. The quality of **policy dialogue**—because that is what GfG is fundamentally a catalyst of and platform for;

II. Measures of **good governance in the organisations and institutions which GfG has supported**—notably their capability, accountability and responsiveness;

III. The analysis of the GfG-GoV partnership's **contribution, through those organisations, to institutional ('rules of the game') reforms** that have had a significant impact on service delivery.

Form of aid

GfG is a standalone project, financed and managed by AusAID. However, it is deeply immersed in Government of Vanuatu systems and people, and wholly aligned with government plans and processes.

GfG will continue to provide accountable grants to competent units of government to take forward agreed reforms. Some aspects of GfG's support are best managed by the units of government involved, within their own structures, systems and—crucially—leadership. For instance, the Government has already shown some interest in obtaining GFG support to manage and address risks in procurement and audit, which have been highlighted in AusAID's Assessment of National Systems.

Estimated budget and timing

GfG was initially intended to run for 10 years, in two five-year phases: 2007-2012 and 2012-17. For internal AusAID budgeting reasons Phase II will be budgeted for four years, from 2012/13 to 2015/16 inclusive, although provision is made in the final year for the design of a putative third phase.

The estimated total costs of Phase II are shown below.

AUD Australian dollars	Total
Program Management	
Core Staff, operational costs, advisers	**3,700,000**
Program Design	**200,000**
Performance/Evaluation	**225,000**
Managed Funds	
Prime Minister's Office	**3,000,000**
Ministry of Finance & Economic Management	**2,250,000**
Energy Sector	**1,000,000**
Aviation Sector	**500,000**
Telecommunication Sector	**2,730,000**
Knowledge, Analysis, Research, Briefing	**1,050,000**
Unallocated (Flexible Fund)	**8,700,000**
Total	**AUD 23,355,000**

Introduction and Design Context

1. The Governance for Growth program (GfG) was established in 2007 within the broad mandate of Vanuatu's 2006 *Priorities and Action Agenda* to help generate economic growth and improve service delivery through good governance.

2. Critical to GfG's original design was a recognition of the need for a deeper partnership between donor and government, able to go beyond sectoral and projectised technical fixes, to address more fundamental policy and institutional issues that shape the pace and quality of economic growth and poverty reduction.

3. Some specific policy issues were identified in GfG's 2006 design which developed into significant GfG-backed reforms. However **GfG was first and foremost constructed as a platform for effective policy dialogue**, able to provide relevant, fleet and flexible support to the Government of Vanuatu's (GoV's) policy and public expenditure choices as they developed. GfG was established as an adviser, facilitator and broker of regulatory reform and improved public expenditure management, for the purposes of improving growth and service delivery. It supports the analytical and consultative processes that inform policy formulation, as well as providing resources for policy implementation.

4. Key design features included establishing and staffing GfG as an extension of AusAID Post, co-located with central government (providing for enhanced levels of dialogue and alignment with government priorities), and high levels of delegated program-level decision-making.

5. **GfG thus represented an important shift not simply in what AusAID did, but crucially in *how it delivered* effective, transformational, development assistance.**

> "The paradigm of development partners operating in the main through direct dialogue at sectoral level means that we are not working at the more strategic and cross-sectoral level required. Departments saw the kind of thing we are talking about as being something on which only more senior levels government could provide an opinion, yet [donors] typically operate, and have their most robust relationships, at departmental level and with departmental staff.
>
> "Of course, countless [donor] staff and consultants beat a well-trodden path to the doors of senior civil servants, and occasionally politicians, at the top end of government. But what is our offering at this level? Where 'what we do' is principally relatively modest, uncontroversial and high-transaction-cost projects at departmental level, what is there to form the substance of a solid relationship and dialogue at this much more strategic level – the level at which, we have concluded, we must pitch our efforts if we are to contribute meaningfully to broad-based growth objectives?"
>
> *AusAID/NZaid 2006 Vanuatu 'Economic Opportunities' study*

6. The 2006 design envisaged a ten-year implementation period, recognising the need for a long-term commitment to achieve and assess the impact of this different approach to development cooperation. The first five-year phase of GfG had an initial budget of A$33 million (although significant additional project funding was subsequently added for infrastructure projects), and is due to end later in 2012.

7. This design document for the second phase of GfG does not rehearse the original analytical and design work. There is already broad consensus on GfG's effectiveness, as assessed through a number of reviews[2] and evaluations, and agreement-in-principle to its continuation.

8. The Phase II design process sought to do three things:

[2] Notably the *Governance for Growth Mid-Term Review*, June 2011 and the Governance for Growth Program Review ('Stocktake'), 2007-2011.

- **Understand and articulate continuing challenges** in achieving equitable growth, how policies and public expenditure choices (including aid flows) are affecting growth, and how those policies and expenditure choices are made.
- **Validate GfG's strengths and weaknesses** – not by re-evaluating GfG's investments, but by identifying where gains from its presence and efforts are felt, how its relationships are different, and how it has forged a more effective form of policy dialogue (as intended under the Port Moresby Declaration, etc.).
- **Articulate the design essentials for the next phase** in the context of a medium- to long-term development partnership between Australia Vanuatu.

Design Process

9. A Concept Note for GfG II was prepared and peer-reviewed in February 2012. It was agreed by GoV and AusAID as the basis of the second phase of the program. Later design guidance asked the design team to consider a program scope limited to:

- The development of a regulatory environment which supports poverty reduction through economic growth; and
- Improved quality of public expenditure management to increase service delivery to those most in need.

10. The subsequent appraisal and design was undertaken by a four-person team[3] visiting Vanuatu for two weeks in late April 2012. (GoV's nominated team member was unable to participate.) The design process comprised a review of prior reports and reviews and interviews with:

- Senior GoV officials in central and sector ministries and other government offices;
- The Reserve Bank of Vanuatu and the National Provident Fund;
- Private sector operators (including the utility companies);
- Industry bodies: the Vanuatu Chamber of Commerce & Industry and the Vanuatu Hotel & Resorts Association;
- Utility regulators;
- Civil society groups, including development NGOs, the media, and the Pacific Institute of Public Policy;
- AusAID officials and managers in Canberra, Suva, at Post and within GfG, as well as DFAT officials at Post;
- Staff and advisers in other development agencies: ADB, European Commission, New Zealand, World Bank.

11. The team also undertook a brief fieldtrip to Tafea Province and there met Council officials and local government agencies, viewed recent AusAID-supported infrastructure work and visited some civil society programs and rural communities.

12. The team's observations and initial conclusions were presented, discussed and broadly endorsed at a meeting of the GoV/AusAID GfG Management Committee at the end of the visit.

[3] Peter Bazeley (Team Leader, Design and Aid Effectiveness Adviser); Steve Hills (Vanuatu Program Manager, AusAID Canberra); Graham Scott (Economist and Public Expenditure Management Adviser); Kevin Smith (Economist, Pacific Division, AusAID Canberra).

Part 1: Analysis and Strategic Context

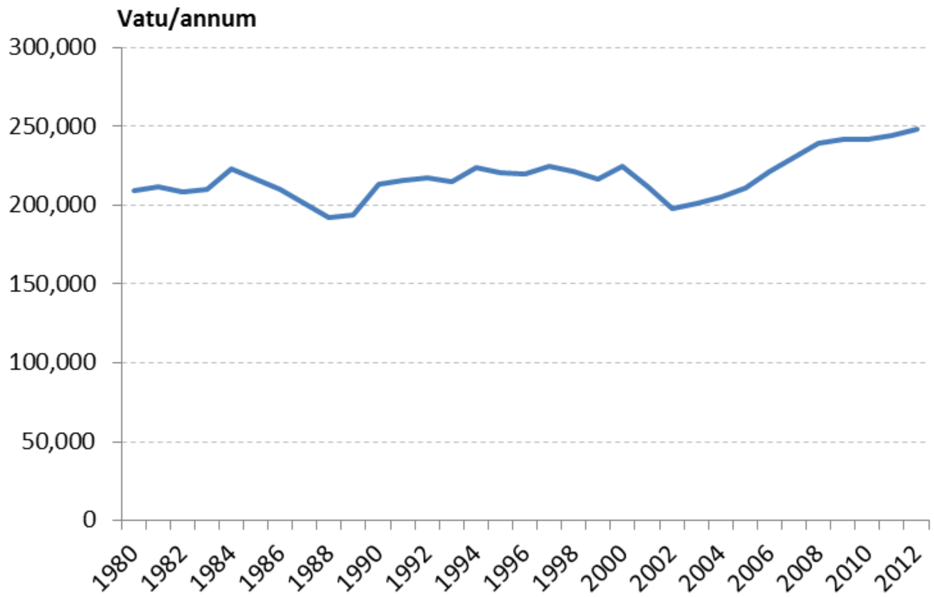
Why focus on ‘growth’?

13. Economic growth is critical to poverty reduction and development in Vanuatu. The country’s population of nearly a quarter of a million[4] is expanding by around 2.6 per cent per year. Nearly 13 per cent of the population live below the national basic needs poverty line[5]. More significantly, the great majority of the population suffer from poverty of opportunity: a lack of access to reasonable quality education, health, basic transport and basic infrastructure.

14. Vanuatu is currently off-track to achieve MDGs 1, 3, 5 and 7, although the country ranks a creditable 125th out of 187 on the UNDP Human Development index, just below Indonesia and above Vietnam[6].

15. Between 1980 and 2002 growth was erratic and real incomes per capita actually fell. Since then, GDP per capita has grown by 25 per cent, and has done so without the volatility of the past. While much of this growth can be attributed to strength in the tourism and construction sectors, it shows the benefits of improved economic management and reform undertaken by the Government of Vanuatu over the period.

Figure 1: Real GDP per capita



Source: IMF WEO Database

16. Net Official Development Assistance received has been between 11% and 18% of Gross National Income for the last 10 years (Figure 2 below), suggesting that while Vanuatu’s economy has—overall—been positive, aid flows remain a critical element of the country’s fiscal construct. In nominal *per capita* terms, Official Development Assistance has increased three-fold from less than US$150 ten years ago to around US$450 in 2010 (Figure 3 below).

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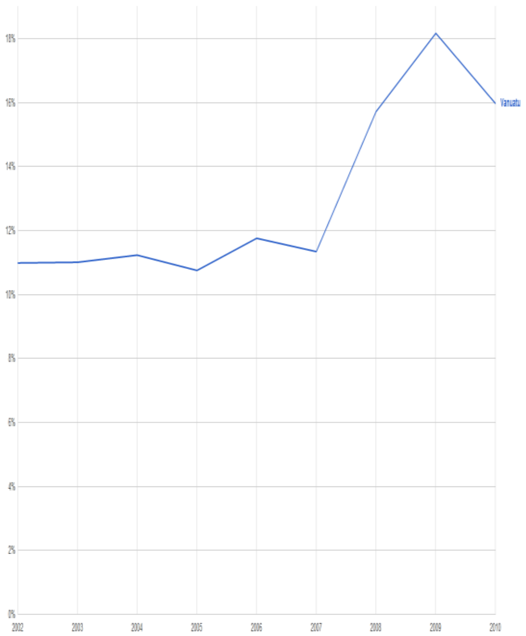
[4] UN Human Development Indicators

[5] Vanuatu National Statistics Office, 2010 Household Income and Expenditure Survey (unpublished)

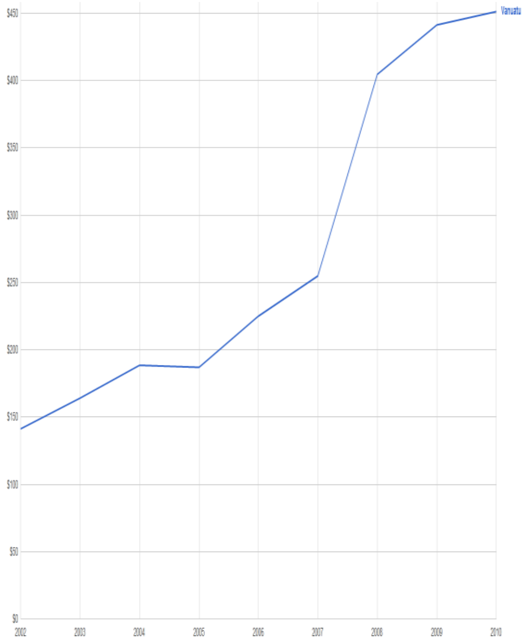
[6] UNDP Human Development Index: http://hdrstats.undp.org/en/countries/profiles/VUT.html

Figure 2: Net ODA received (% of GNI)



Source: World Bank, June 2012

Figure 3: Net ODA per capita (current US$)



Source: World Bank, June 2012

17. Also critically important in the Vanuatu context is the quality and equity of that growth. The economy remains highly dualistic, with the great majority of growth in the urban areas of Port Vila and (to a lesser extent) Luganville. Yet three-quarters of Vanuatu's population is rural and, to a large extent[7], not yet fully participating in the formal—or even cash—economy.

18. There is evidence that rural-to-urban migration is resulting in increased poverty as migrants fail to find formal-sector jobs but lose the security of subsistence support in the islands. So, while 10 per cent of the rural population live in poverty, urban poverty rates are much higher—18 per cent in Port Vila and 24 per cent in Luganville—is as lack of opportunity in rural areas drives migration into the urban centres.

Addressing growth

19. GfG's original conceptualisation and design was in part informed by a 2006 AusAID/NZaid-funded analysis[8] of economic opportunities, focusing on the productive sectors and rural growth in particular.

20. The 2006 analysis saw the impediment to accelerated and broader-based growth to be multiple inefficiencies—in the economic[9] sense—throughout the value chain. These occurred in both the private and public sectors. Efficiency throughout the value chain is essential to Vanuatu's ability to compete in international markets, given the constraints it faces in terms of geography, diseconomies of scale, fragmentation and lack of agglomeration.

21. In order to address this, more locally-owned analysis of constraints to growth and of policy and public expenditure choices needed to be generated. This would include a deeper

[7] There is reportedly now more cash entering the rural economy, attributed to high agricultural commodity prices, (limited) amounts of outer island tourism, and increased demand as (for example) mobile telecommunications reach rural areas.

[8] Bazeley, P. and Mullen, B.; 'Vanuatu Economic Opportunities Fact-Finding Mission', July 2006, AusAID/NZaid www.ausaid.gov.au/publications/documents/vanuatu_growth.pdf

[9] *Economic inefficiencies* are situations where waste, friction or other undesirable economic features are present which could be changed such that everyone gains, or so that some gain while nobody loses.

understanding of the private sector and its ability to contribute to broad-based growth. The analysis encouraged a more responsive relationship between government and the private sector, which would help determine how policy and public expenditure could best support strong but equitable private sector-led growth.

22. GfG set out to provide a platform for AusAID to engage in such a 'policy and institutional' agenda, focussing on those very issues that were highlighted in the 2006 review: the locally-driven analysis of the drivers of private-sector-led growth, of the quality of policy and public expenditure choices, and the more efficient and effective delivery of service delivery and infrastructure investments.

23. It also constituted a new type of aid relationship and way of delivering aid: an AusAID-staffed extension of Post, located in close and accessible proximity to the central agencies of government and able to respond quickly and adeptly to genuinely transformational policy windows—things that would make a real difference.

24. An overview of development in Vanuatu and an update on the development challenges that GfG faces is provided at Annex 1.

Harmonising aid flows with GoV strategy for growth and service delivery

25. Annexes 2 and 3 elaborate on some concerns about distortions to the development strategies from the aid flows. Distortions in this context are policies, actions and omissions related to the aid flow that result in development outcomes falling short of their achievable potential or even causing deterioration from the status quo.

26. Annex 2 argues that there are opportunities for improved macroeconomic policy by way of better understanding of the impacts of monetary and fiscal policy on volatility in the economy, competitiveness and private sector development.

27. Annex 3 asks how assured AusAID and GoV can be that distortions of these kinds are not holding development below its achievable potential. The annex provides some indicators of potential distortions that could flow from weaknesses in policy dialogue, governance analysis and implementation of policies. It concludes there are reasons for some concerns that institutional arrangements are not attending to actual and potential distortions to factor proportions in the development program. These are distortions to fiscal choices and factor proportions (labour, capital, natural resources) and also macroeconomic instability.

28. Broadly, the GoV meets current expenditures from domestic revenue sources while capital expenditure is largely aid financed. The domestic revenue base is very weak and the revenues it produces are inadequate to support the infrastructure that has been financed by donors. Developments in tax policy and administration are needed to expand the tax base and make collection processes more effective.

29. Forty per cent of the current expenditure is spent on wages, which the IMF is advising be constrained to meet fiscal stabilisation objectives. Wages are very low and this compromises the achievement of service delivery goals.

30. Over time AusAID's Vanuatu program has been increasing its support for current expenditure with examples in road maintenance, utility regulation, grants to schools and in health. However these arrangements are specific to the various programs and there is not yet in place a more comprehensive system within the budget for incorporating ongoing current cost requirements alongside the capital costs of development activities. The risk of capital assets not being maintained or provided with complementary current expenditure allocations remains.

31. The general preference for infrastructure to be financed from aid and current expenditure to be financed by domestic revenue sources can lead to distortions in the allocation of capital and labour resources in other ways. Public services are more labour intensive than infrastructure investment. The building of a road for example using modern

methods and machinery has lower requirements for unskilled labour than ongoing road maintenance. Providing rural health services uses local labour more intensively than building a hospital. So the preference of donors for capital projects can distort the mix of capital and labour inputs to production and lower the demand for local labour below where it otherwise might be.

32. Furthermore, many of the service-related development outcomes that GoV and its partners seek—for example in health and education—are heavily dependent on recurrent (rather than capital) expenditure. As the World Bank's July 2012 Discussion Note *'Pacific Futures'* suggests, improving the allocative efficiency of aid by increasing use of country systems and budget support (among other things) is likely to be important as foreign assistance continues to play an integral, long-term, role in the economies of the Pacific.

33. Institutional arrangements to identify and address any such biases require attention to the policy dialogue and the systems for decision making, policy implementation and service delivery. The way to analyse and address these risks is not unique from other efforts to harmonise the aid program with the development strategy. In other words addressing these issues is just another item in the agenda of policy dialogue and has consequences for GfG's role in relation to the dialogue. The issues fit neatly within the proposed foci for Phase II of GFG (para 92)92 below:

- Improved public expenditure management 'downstream'; and
- Connectivity between emerging macroeconomic issues and development strategy.

34. Annex 3 draws on the Assessment of National Systems (ANS) and argues that improvement in the quality of public expenditure requires building on past achievements in budgeting and financial management and addressing the broader landscape of public management issues by attending to nine specific areas of weakness. Advice is provided on how to move with justifiable confidence to place more weight on the use of PGS. The ANS report is quoted to provide the work program for attending to the main issues requiring immediate attention to shore up the PGS and support greater use of these systems by donors. This will enable further steps along the road to General Budget Support that is the solution in principle to the issues of aid-induced distortion to development. In reality this requires major upgrading and effectiveness in the systems of service delivery, combined with a durable and robust state of trust between GoV and its development partners around the implementation of policy and public expenditure intents.

35. Gaining confidence in the PGS must include clear and unbiased reporting on results both in terms of building system capabilities and in service delivery. With respect to the financial management system it is helpful that the PEFA diagnostic is being updated and so will permit a revision and report on progress on the material in the ANS. A specific agenda for further PFM reform can be developed that updates the proposed topics in the ANS report to reflect the latest PEFA diagnosis.

36. Service delivery measures that have already been developed in various sectors can be linked where appropriate to the core of the public management and financial system so as to link service delivery results with central policy goals and funding streams.

The role of governance in addressing growth

37. Economic growth and development outcomes are not just the consequence of technical economic policy settings. They are the result of economic, social, political and institutional forces that determine the availability of resources, their deployment, their transformation into public and private goods and services, and productivity improvements over time. These complex and diverse forces shape the incentives, opportunities and constraints around decision-makers, from individuals to the largest and most sophisticated economic organisations. Collective action—both private and public—to promote economic development does so through manipulating this environment in ways that the decision-

makers calculate will change things for the better. These calculations are not always right, so interventions evolve in response to experience and changing circumstances.

38. A way to address this complex situation, which is in common use in developing countries, is a diagnosis of the immediate constraints on economic growth[10], resolve these and move on to the next agenda. There may not need to be a grand plan in order to succeed, and more likely the planners will make mistakes. Not only will the agenda evolve but also the institutional arrangements—the rules of the game—and actors within them. It is their commitment, skills and actions that lead to necessary change. Economic growth is by nature the result of successful co-evolution of policies, capabilities, politics, society and values.

39. This reality should alert GfG to the need for modesty about its impact on economic growth. Nonetheless, it is uniquely positioned, well-resourced and motivated to promote and collaborate on initiatives that are likely to promote economic development. Its past achievements in promoting better financial management, better regulation of markets and infrastructure development are widely accepted as valuable contributions to better governance.

40. Decisions on GfG's work program should emerge from the partnership policy dialogue. Interventions should be identified through that dialogue that address constraints to economic efficiency and are significant in their effects on the economy and on the GoV policy agenda.

41. More could be done by way of technical analysis to prioritise the most serious constraints on development and risks. The conclusions from the 2006 review (noted above) and other analysis of the economy should be continually questioned and refreshed. Also there is much work needed towards building a more effective system of public management that makes evidence-based decisions about polices and resources, and then implements efficiently. The weaknesses in this system stand out as a crucial constraint on development.

42. The design of GfG II includes a sharper focus on two areas:

- **Improved integration and coordination of macroeconomic policy, development strategy, fiscal policy and managing donor resources** – all on a multi-year time frame.

  The latest IMF report[11] highlights risks in the macroeconomic situation that call for sophistication in maintaining balance between the main macroeconomic variables – inflation, production and employment, the exchange rate and balance of payments and the stability of financial markets. Working with the Reserve Bank of Vanuatu, MFEM, PMO and other stakeholders with an interest in this area, GfG should promote analysis and communication, not only about the macroeconomic situation, but also the related medium and long term development strategy. It should promote analysis and discussion of the constraints on the development of the private sector economy and the policies—both macroeconomic and microeconomic—to remove these constraints.

  Included in this area of work should be work with the MFEM budget officials to build an integrated system of fiscal management that enables well informed decisions on a multi-year time frame. The system should highlight choices for the use of fiscal and donor resources, identify their impact on development and analyse all resources available in an integrated way. It should not be distorted by poorly designed institutional processes around budgeting and donor resource flows. Attention is needed to the impact of the large donor flows on stabilisation, sectoral allocations and distortions to the relationship between recurrent and capital expenditure.

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[10] Hausmann, Rodrik and Velasco, *Getting the Diagnosis Right*, Journal of Finance and Development, Vol 43 No1, March 2006

[11] Staff report for the 2011 Article IV Consultation, International Monetary Fund, April 2011.

- **Extending the central system for budgeting and finance to become a Government-wide system of financial management, reporting and accountability**.

  Recent analysis of the strengths and weaknesses of the financial management system have shown strong progress in areas where the MFEM has a high degree of central control, but away from the centre the weaknesses multiply. Areas of weakness requiring attention and development are:

  - Tax administration;
  - Medium term expenditure planning and management;
  - The coverage of off-budget entities and contingent liabilities from Government Business Enterprises (GBEs) and local government;
  - Legislative scrutiny of budgets, accounts and audit reports;
  - Procurement;
  - Audit, both internal and external.

43. Within these two areas of work, GfG's core role could be characterised as assisting the authorities to make better decisions and build a better system for their implementation.

44. Annexes 2 and 3 elaborate on these two main themes or result areas. Annexes 5 and 6 provide draft TOR for the advisers to take them forward.

45. In addition, GFG should continue to contribute to Vanuatu-led activities which lead to the development of a sustainable, dynamic economy in which the private sector can flourish and which delivers tangible improvements in the wellbeing of citizens. This includes helping the Government to consolidate the roles of regulators and the functioning of markets. It also means being ready to provide analytical, technical and financial support to those activities that will provide the basis for broad based growth into the future.

Ownership and the demand for better governance

46. It has become common in development circles to question the framing of reform agendas in terms of the supply and demand for reform[12].

47. Development agencies pressing for best practice governance arrangements and encouraging the empowerment of citizens to hold service providers accountable has had mixed results. The former can downplay the reasons for the resistance to reform and the latter can ignore the reality of low capacity and funding within the service delivery systems. Some researchers are framing the issues as problems in collective action. The following quote[13] illustrates the point:

> *... Reformers and their international supporters need to abandon the straitjacket of principal-agent thinking.*
>
> *In that thinking, programmes divide between those that address the so-called 'supply side' of improving governance and those that emphasise the 'demand side'. In the first case, the assumption – usually unstated but logically necessary – is that governments want and need help to deliver development honestly and effectively. In the second case, an alternative assumption is made: that, whilst the commitments of governments are open to question, their citizens have a definite and uncomplicated interest in holding them to account for their performance as agents of development. Reforms should be about stimulating this 'demand'.*

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[12] https://blogs.worldbank.org/governance/the-centrality-of-collective-action-problems-in-governance-for-development-new-evidence

[13] David Booth, "Development as a Collective Action Problem: Addressing the Real Problems of African Governance", African Power and Politics Program, Overseas Development Institute, London

This report disagrees with this framing of the choices facing governance reformers. It argues that governance challenges ... are not fundamentally about one set of people getting another set of people to behave better. They are fundamentally about both sets of people finding ways to act collectively in their own best interests.

48. GFG should carefully assess the 'reform space' available and look for opportunities to expand it into opportunities for transformational change and avoid being overcommitted to particular theories of reform. However the quotation above offers some insight into how GFG might conceive of its role as promoting collective action by the parties whose cooperation is needed to progress its agenda items. This might lead to innovations in dealing stakeholders and methods of engagement.

49. This may involve changes primarily in the manner of engagement with the GoV and other stakeholders. Its positioning would promote active engagement with stakeholders in designing projects but within the envelope of feasibility set by the bounds of its primary relationship with the GoV. While this engagement might result in less rigidity than the conventional orthodoxy there is no fundamental reason why it cannot be adapted to support the GFG program. The adjustments will be about how the various steps in the processes are conducted.

Lessons learned from GfG Phase I

50. GfG has been widely praised for its relevance and utility by GoV, other stakeholders and through reviews and evaluations. It is credited with having provided pivotal *'right thing, right place, right time'* support to major policy and institutional reforms, including in the telecoms and power sectors, rural electrification, transport infrastructure improvements, fee-free education, and strengthening of public financial management. Annex 10 provides a summary of GfG Phase I's principal interventions and the outcomes.

"GfG was founded on the principle of strategic opportunism. It was not intended to be a long-term institutional strengthening program. It was deliberately designed not to be that—having followed long investments in MFEM and the PSC.

"Its objective was to support governance reform which contributed to improvements in growth or better service delivery—that was about as specific as we tried to be."

One of GfG I's original AusAID designers

51. GfG's success is frequently attributed to:

- Its physical accessibility—located not in the High Commission but in a central Government of Vanuatu compound;
- The informality and approachability of its ways of working, its communication and interface with government staff, and its immersion in the real processes of policy-making;
- Its backing of GoV's own policy efforts and aspirations, while exercising discretion and adding value through support and advice;
- Its willingness to be entrepreneurial, strategically opportunistic and to some extent risk-taking (in a policy sense), while maintaining absolute integrity over AusAID funds and resources;
- Its commitment to support the full policy development cycle, from dialogue through to implementation;
- Its understanding of and sensitivity to the political economy of policy-making in Vanuatu;
- Its engagement with multiple stakeholders in economic policy and service delivery: central and decentralised units of government, other development agencies and the banks, the private sector, civil society;

- The seniority[14], credibility and delegated authority of its carefully selected AusAID leadership, working closely with the Head of Post;
- The quality and positioning of its [mostly ni-Vanuatu] staff;
- The trust that has been established and respected;
- The robustness and quality of its analysis and advice.

52. In a separate, ODE, evaluation of the effectiveness of policy dialogue in AusAID[15], which did not use GfG as a case study, many of these very same attributes are recognised as constituting best practice (see '*Top Tips for Tip-Top Policy Dialogue*', Annex 9).

53. GfG's strength was also in its open and flexible mandate, providing for the 'strategic opportunism' that yielded some of its big wins. This was as right as it was innovative, and it got results.

54. However, as time has gone on and different pressures have been brought to bear on GfG, some of the original clarity of purpose has been diluted. Factors might include:

- GfG started with some known 'big-ticket' policies issues already on the table (notably telecoms)—'low-hanging fruit'—with which it was able to achieve early success. As these were dealt with, and as some more complex initiatives met with less-immediate success, there was a degree of casting-around for new initiatives to support.
- As the aid budget increased significantly from 2007 (para 16 and Figure 2 above), there was a ready availability, if not incentive, to increase GfG's spend. But policy and governance work is not a big spender. GfG therefore assumed a significant new direction with responsibility for the programming and management of some large and finance-heavy infrastructure projects that *emerged from* policy dialogue. This placed strain on its deliberately small and flexible staff, and it shifted the predominant (and healthy) preoccupation of GfG with transformative interventions to managing much more transactional projects (although the distinction between the two is somewhat blurred, especially in the case of infrastructure—see Annex 10).
- As discussed in Annex 1, 'governance' is a broad term and can be interpreted variously. The foray into managing infrastructure investments might be an example of too-broad an interpretation.

55. The complexities and unpredictability of the politics of major policy and public expenditure choices has also been apparent. Even some of GfG's flagship successes—for example its support to telecoms and power sector reforms—have been shaken by seemingly contrary political machinations. This is no indictment of GfG, but it does highlight the subtleties, the cross-governmental and highly political context in which GfG operates. This is a context which the program must properly understand. Policy development is not a linear process, it is not predictable, and it does not sit easily with any pressure to spend (points also emphasised in the recent ODE evaluation of policy dialogue across AusAID).

Locating the demand for reform

56. Allied to this, Phase I experienced some loss of confidence in where the demand for really reform was and how, practically, to build on such demand. This manifested within government, in the connectivity (or lack of it) between government and civil society and the private sector, and in the breadth and robustness GoV's direction of GfG itself.

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[14] GfG is directed by a full-time '*Executive Level 2'* AusAID public servant—the equivalent of a Counsellor at Post.

[15] *An Evaluation of Policy Dialogue in AusAID*, Office of Development Effectiveness, AusAID, Canberra (2012), in press. www.ode.ausaid.gov.au

57. Paras 46 to 49 above discuss this from a 'demand for better governance' perspective, but there may also be more administrative developmental factors. Explanations have included:

- Limited government experience in planning or managing a development (capital expenditure) budget – which means that the engagement, when talking about non-recurrent elements of the agenda, tends to be—in the first place—a dialogue among development partners.
- Limited articulation of what—in practice—the development agenda is: of how the aspirations of the Priorities and Action Agenda, for example, translate into prioritised, costed and sequenced policy and public expenditure choices, certainly. But also in terms of donor strategy: the unambiguous articulation of values and interests and intelligent plans calculated to deliver efficiently against the challenges identified.
- The limited pool of people with whom to engage in processes of consultation, both within government and between government and external stakeholders. This is due in part to the inescapable smallness of institutions, but also to issues such as policy capture, and to the understandable tendency—and short-term effectiveness—of supporting proven *champions* of change. (As opposed to the more difficult, but perhaps more robust, building of broader-based *coalitions* for change.)

58. In Phase II, while principally remaining a resource of central government, GfG can and should do more to build a wider awareness—throughout government and in society—of the implications of policy and public expenditure choices and the relevance of engaging in those processes. (Whether they are at the macro level, or simply in the governance of GfG itself.)

Policy dialogue and informing the policy debate

59. As highlighted above, GfG exhibits many features of best practice in supporting and prosecuting policy dialogue, and these features must be maintained.

60. However, the evaluation of policy dialogue in AusAID noted a number of other features which are important, as well as some pitfalls which GfG II should be aware of. Particularly the issue of agreeing policy shifts where key stakeholders may not fully understand or support the reforms (the ODE evaluation talks about this in terms of *"A nod is not enough"*). The design team was aware, for example, that some of the regulatory reforms that GfG supported—for example telecoms—have subsequently met with some resistance if not near-rejection.

61. This is no criticism of GfG: it is to be expected. But GfG should recognise this feature of the 'political economy of policy dialogue' and invest in managing it proactively in Phase II.

62. Key to this is building and equalising the 'negotiating capital' of key stakeholders during the policy debate, such that all sides are able to assess and articulate their policy positions clearly and—as much as possible—do so on the basis of shared and locally-owned evidence. Strong policy dialogue should also clarify expectations of what a particular reform will bring. This may not have occurred with the regulatory electricity and telecoms regulatory bodies.

63. Properly understanding the political economy that drives decision-making is also crucially important, and needs to be worked with, not against.

64. For this reason the budget for Phase II has been expanded in its 'Knowledge, analysis, research and briefing' line to allow for greater and more structured building of stakeholders' negotiating capital and the use of evidence to inform Government of Vanuatu policy-making at all levels, including the political. GfG will do more in its second phase to support the generation of locally-owned evidence to inform policy debates and, in particular, to present that information in appropriate forms to those whose aspirations and responsibilities shape

policy decisions. The relative immaturity and fragility of political institutions in Vanuatu presents a particular challenge in communicating policy options and the evidence base behind them.

Policy contexts

The Partnership for Development

65. The purpose and objectives of GfG align closely with the Australia-Vanuatu Partnership for Development (2009), which came into effect part way through the first phase of GfG. The Partnership has set out a shared vision for close cooperation to meet common challenges, achieve development outcomes and deliver sustainable improvements in the quality of life of all Vanuatu citizens.[16] The outcomes statement from the most recent Partnership Talks reaffirmed shared commitment to a long-term development partnership.[17]

66. The Partnership for Development will be updated over the next 12 months as the timeframes set in the 2009 agreement expire. Given the central importance of economic development in all Vanuatu's policy statements, the alignment of the program with the shared priorities of the Vanuatu and Australia is unlikely to be negatively impacted.

Australia

67. Australia has an enduring commitment to support the development of its Pacific Island neighbours. Australia is the largest bilateral donor to the Pacific Island Countries, accounting for around half of all ODA (approximately $1.1 billion in 2011/12) and is committed to retaining a leadership role within the donor community[18]. The innovative approach of GfG takes advantage of Australia's relative size as a donor and capitalises on mutual trust and respect forged by this partnership to engage in an open and frank discussion about economic issues.

68. Australia remains committed to using bilateral programs as its primary vehicle for development assistance in the Pacific. In 2012/13 Australia will deliver a bilateral program of approximately $55 million (complemented by approximately $18 million in regional program activities in Vanuatu).

69. The Australian Government's 2011 policy statement, *An Effective Aid Program for Australia: Making a Real Difference – Delivering Real Results* ('An Effective Aid Program'), identified effective governance and sustainable economic development as two of the five core strategic goals for Australian aid.

70. The policy goal of effective governance is broken down into three objectives:

- Delivering better services;
- Improving security and enhancing justice;
- Supporting human rights and democracy.

71. The policy goal of sustainable economic development has four objectives related to:

- Food security, rural development and social protection;
- Private sector development and trade;
- Transport, energy and communications;
- Climate change.

72. GfG Phase II will focus on both effective governance and sustainable economic development, but without defining a specific sub-sectoral (objective) mandate. This is in

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[16] Australia-Vanuatu Partnership for Development, p.2

[17] Australia-Vanuatu Partnership Talks Outcomes Statement, August 2011

[18] *An Effective Aid Program for Australia: Making a Real Difference – Delivering Real Results*, p.41

keeping with principles of agility and flexibility of this design, through which GfG will be defined by its role and function—not by the sectors in which it operates.

Vanuatu

73. The goal of the program is taken directly from the vision articulated in Vanuatu's Priorities and Action Agenda 2006-2015.[19]

74. Throughout the policy documents and across the Vanuatu Government there is clear evidence that 'governance' challenges are a major barrier to the delivery of services and to unleashing the economic potential of the islands and their people.

75. Vanuatu's policy settings are currently being redeveloped. The Priorities and Action Agenda is being updated and due before Cabinet in 2012. The updates and revisions to the PAA will need to be considered, however early drafts suggest the principles will remain well aligned. The key governance obstacles to achieving growth and service delivery identified at GfG's inception are still features of Vanuatu's economic and political landscape:

- Lack of a clear and coherent national economic policy focussed on long-term development;
- Poor outcomes on policy implementation;
- Weak public expenditure management, despite reasonably sound budget processes and financial management – quality of expenditure is poor and the budget does not have a strong policy basis;
- Limited policy and regulatory settings, in terms of both quality and quantity;
- Inadequate investment in infrastructure (and in particular the recurrent maintenance costs of any such investment).

[19] *Priorities and Action Agenda 2006-2015*, p.1

Part 2: Program Description

76. The Governance for Growth program (GfG) was established in 2006/07 with the **overarching goal** of helping to achieve the vision articulated in Vanuatu Priorities and Action Agenda 2006-2015: **an educated, healthy and wealthy Vanuatu**[20]. As this Phase II design process has reinforced, widespread, sustained improvements to the environment that might enable such a goal **require effective governance** that results in high quality policy and public expenditure choices being made and implemented. **Supporting, facilitating and brokering effective governance is what GfG does**.

77. Conceived on the back of a strong bilateral relationship and a shared long-term commitment to Vanuatu's development, GfG was designed as a ten-year program of two phases. The first of these comes to an end in December 2012.

78. The design of GfG's second phase builds on the established momentum, direction and emphasis of GfG, including its ways of working and its staffing. But it also seeks to provide a clear focus and mandate for GfG II based on functions (as opposed to sectors), and it responds to lessons learned from Phase I and updated analyses of the economic and developmental context.

Program Objectives

Purpose	**To generate economic growth and improve service delivery through good governance** GfG constitutes the principal vehicle for the Australia-Vanuatu Partnership for Development's 'Partnership Priority Outcome 4: Economic Governance'.
Result Area 1	**Vanuatu's policy framework is more supportive of durable, equitable and broad-based growth** *Better policy development* through better evidence, based on better analysis and better communication of policy options
Result Area 2	**The quality of Vanuatu's public expenditure and its management is improved** *Better policy implementation* through better public expenditure choices and better public expenditure management

79. The objectives are discussed in further detail in Annexes 2 and 3.

80. These objectives closely mirror GfG's original objectives, as set out in its initial design, although they now emphasise 'equitable' growth. The 'Improved Infrastructure' result area that was added to GfG I after it assumed responsibility for the Vanuatu Transport Sector Support Program is to be reallocated to other parts of the AusAID country program. This is to allow GfG to focus on its core function of supporting transformative policy and institutional reforms. Ongoing management of the implementation of the implementation major programs not only caused dilution of GfG's otherwise very targeted efforts, but it also generated—in places—a sense that GfG was an alternative source of donor funding.

[20] Priorities and Action Agenda 2006-2015, p.1

GfG's role – what does it actually do?

81. This design document is for the second phase of a program that is already up and running, continues to be relevant and effective, and is highly regarded. Unsurprisingly therefore the design recommends few substantive changes. Indeed, this Phase II design reinforces the original design parameters and recommends that GfG divests itself of the more transactional program implementation work that was added to GfG part-way through Phase I.

82. GfG's primary role will thus continue to be that of a key facilitator, adviser and broker—where opportunity arises—of:

- **Regulatory reform**, for the purpose of generating meaningful, robust and equitable ('pro-poor') economic growth; and
- **Improved public expenditure management** to increase service delivery to those most in need.

83. Annex 10 summarises what GfG has done to date and what changes, from an institutional perspective, it facilitated, supported and brokered.

84. GfG's principal tool is a small but highly capable, and deeply-immersed permanent staff—including national staff with exceptional institutional experience and political savvy—who are able to engage in policy dialogue with the most senior levels of government on a daily basis, both formally and informally, and draw-in resources to support policy development as needed.

85. That support may take the form of internal or externally-commissioned research and analysis, short- and medium-term advisory and legal inputs, support for policy development processes such as stakeholder consultations and briefings, short- and medium-term capacity-building, and pilot projects. GfG support is characteristically often provided with great agility.

86. To remain effective, it is important that GfG continues to provide the resources to see-through policy development and institutional reform to implementation. (But see para **Error! Reference source not found.** and "GfG's operating modes" in Annex 1 about exit strategies.)

87. The resources may be AusAID resources: either drawn from GfG's own immediately-available and initially unallocated 'Flexible Fund' or—in the longer-term—through the AusAID bilateral program pipeline. But importantly GfG should continue to emphasise, its brokering, intermediary, role in drawing-in and leveraging resources from others, typically, the Multilateral Development Banks, other bilateral donors or the private sector.

88. GfG should continue to test innovative modalities in pursuit of its objectives. Performance-linked aid instruments have had a particular role in some of GfG's most successful work.

89. While GfG is an initiative that is explicitly linked into central government and its priorities for reform—particularly the Prime Minister's Office and the Ministry of Finance and Economic Management—it is instrumental in forging dialogue and coalitions with a wide range of stakeholders: the private sector, decentralised units of government and industry regulators, civil society and the media, and other donors and development agencies.

90. Accordingly, the work program for GFG will be driven by demand from Government for GfG's analytical, technical or financial support to reform. Therefore the discrete Phase II activities for GFG cannot, by and large, be prescribed in this design, but Annex 11 provides an outline of the likely first-year priorities and commitments for Phase II, and pipeline budget.

91. Neither can the program's areas of focus be limited to specific sub-sectors. This is in keeping with the principles of agility and flexibility which have been among GfG's key

strengths. In phase II GfG will be defined by its role and function, not by the things it does or the sectors in which it operates.

New areas of focus

92. As above GfG will continue to focus on regulatory reform and improved expenditure management. However, emerging from this Phase II design process, GfG's capabilities will be expanded to include in-house analytical expertise in support of two imperatives:

- GfG will expand support to **improved public expenditure management 'downstream'**, beyond the central ministries, to decentralised units of government. Following generally successful reforms in, and strengthening of, central ministries' budget and public financial management systems, the challenge now is to extend this capability to those parts of government that are using those resources to deliver services to citizens. Annex 3 expands on this, and draft terms of reference for a GfG adviser to support this are provided at Annex 6.
- GfG will expand its capabilities to support greater **connectivity between emerging macroeconomic issues and development strategy**, not least the apparent imbalance between the [principally GoV-funded] recurrent budget and the [principally donor-funded capital budget]. Core activities will be to provide the macroeconomic analysis and modelling to support a multi-year fiscal strategy that better integrates capital and current expenditure. This should include analysis and advice on the macroeconomic and distributional implications of the flow of resources from donors. Annex 2 expands on this, and draft terms of reference for a GfG adviser to support this are provided at Annex 5.

93. GfG should increasingly engage and consult with **political and business communities** in Phase II. They have often presented the most potent challenges to regulatory reform. The use of GfG's research fund (which has been under-used to date) has been boosted in the Phase II budget and re-termed a 'knowledge, analysis, research and briefing' fund, with the intention that GfG II invests more proactively in the production of short, easily digested and fit-for-purpose briefs and digests—to better inform political and business communities about policy and regulatory options.

94. Similarly, GfG should seek to place greater emphasis in Phase II on **understanding the demand for better governance** by supporting more robust and better institutionalised processes of civil society engagement in policy choices and expenditure accountabilities. This is not to say that GfG becomes a 'building demand for better governance' program per se, but that it promotes the understanding of the need for, and pragmatically supports, collective action across diverse parties and stakeholder groups—including government, civil society and the private sector—to progress durable policy reform. (Paras 46 to 49 above refer.) This applies as much to the choices GfG itself makes as it does to the wider governance agenda.

What GfG should not do

95. GfG should divest itself of its management responsibilities for more transactional elements of development. Its focus is on transformational policy and public expenditure management.

96. In the first instance this means that GfG's management of the Vanuatu Transport Sector Support Program, and its responsibility for the Australia-Vanuatu Partnership for Development 'Priority Outcome 3: Infrastructure', would be transferred out of the GfG office to the regular structures and management arrangements of the bilateral program.[21] The GfG

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[21] For internal AusAID financial planning purposes, the budget line for the proposed Infrastructure Adviser will still show in GfG's budget for the time being.

staff that have been supporting the infrastructure program would however remain in GfG and revert to working on core GfG activities.

97. It is also important to design-in GfG's exit or handover from the start of any involvement. GfG's role is not as a long-term financier of development projects but as an agent of change, supporting transformative policy and institutional reforms. That may involve some financing, but not the major long-term financing of development. Sustained impact is achieved when GoV operations assume different responsibilities and are more effective than before. Where longer-term programs are no longer contributing to a regulatory or public expenditure change (for example infrastructure and its maintenance, or school grants), then those programs need to be handed over to an appropriate source of longer-term finance—GoV itself, AusAID's bilateral program or other donors and development partners.

Operating Guidelines

98. GfG must have a clear protocol for engaging and then disengaging with activities that significantly absorb its resources. GfG needs to be responsive and 'helpful' to preserve its reputation, its relationships and its access; this means it cannot always refuse to do small things because they are not on the strategic plan. Often these can be an entry point to a significant piece of work or an opportunity to gain useful insight into the workings of an area of the GoV. But at the end of the year GfG has to be able to point to some important and high impact interventions that are squarely on its mandate and strategy.

99. Criteria for deciding when to become significantly engaged on an issue should include that the intervention will assist in:

- Easing a major constraint on economic growth by way of skills, technology, finance, business services and support, financial and commercial literacy, bottlenecks in key infrastructure;
- Facilitating better decision making about the directions of public expenditure including aid sourced funds;
- Lifting the capability of a ministry with big development impacts to improve its policy formulation and service delivery;
- Creating and promote better service delivery in the rural areas and small towns;
- Creating a more enabling and supportive environment for the development of the private sector;
- Improving the effectiveness of regulations that impact on businesses, investors and consumers;
- Making Vanuatu more attractive to quality foreign investment.

100. The planned intervention should be consistent with the overall Vanuatu-Australia Partnership for Development. In particular the intervention should not trigger off unintended negative consequences and resource use by others without their understanding and their consent. It should also be sustainable; when the work is done some piece of the GoV operations will take more responsibility and be more effective than before.

101. Applying these criteria implies having a clear exit plan from any project as part of the entry criteria. Some activities represent an ongoing process of reform (rather than a project). In such instances the engagement will be long and the exit time hard to forecast. GfG assistance for financial management reform has this character, as does the proposed support for macroeconomic and development planning. If the exit is unclear, the process of engagement should have established milestones that can be monitored.

102. A further guiding principle should be the continued application of good practice in *policy dialogue* (Annex 9 reproduces a one-page summary of ODE's evaluation of policy dialogue on AusAID, much of which GfG already espouses). This should include the important principle of working towards robust 'coalitions' for change: supporting collective

action on both the supply and demand side of 'good governance' by the parties whose cooperation is needed to progress agenda items. (Paras 46 to 49 above refer.) This perhaps more deliberately than in Phase I, where the emphasis was often focused on supporting 'champions' for change. This is a more subtle interpretation of the proposal that GfG Phase II should do more to "build demand for better governance", in that a more conventional civil-society, advocacy-orientated, focus on building demand for better governance would not always sit easily with GfG's unique positioning in government dialogue.

What does success look like?

103. As discussed in the preceding section, Economic growth and development outcomes are not just the consequence of technical economic policy settings. They are the result of economic, social and political forces that determine the availability of resources, their deployment, their transformation into public and private goods and services, and productivity improvements over time. What success looks like, and how much can be attributed to GfG's support, needs to reflect that reality.

104. In Phase I success was defined in terms of PEFA scores, GDP, school enrolments, MDG health measures and international measures of transparency, ease of doing business and aggregated World Bank indicators of governance.

105. These are high-level indicators of some of the aspirational outcomes of better governance, but they are not appropriate measures of GfG's success. There is no evidence that these measures have been used in terms of 'managing for results', as is expected under the Partnership for Development.

106. To provide a more tangible measures of GfG's success, the Phase II design defines outcomes and impacts at three levels (on which Part 3 expands):

I. A quality and effectiveness of policy dialogue—because that is what GfG is fundamentally a catalyst of and platform for;
II. Measures of good governance in the organisations and institutions which GfG has supported—notably their capability, accountability and responsiveness;
III. The analysis of the GfG-GoV partnership's contribution, through those organisations, to institutional ('rules of the game') reforms that have had a significant impact on service delivery.

107. Ultimately, whether the decision to invest in GfG was 'right thing, right place, right time' will be judged by a reversal of some of the irregular and insufficient **growth** that was described in Part 1; but this will not be clear within the internal cycle of GfG planning and programming.

Form of aid

108. GfG is a **standalone project**, financed and managed by AusAID. However, it is deeply immersed in GoV (systems and people) and so closely associated with GoV's own policies and spending priorities, that it is **wholly aligned with government** plans and processes.

109. As discussed above, GfG's role is one of supporting short to medium-term transformational interventions and investments. The sustainability of these derives from government or other institutions assuming different responsibilities and being more effective than before. Those transformations may carry transaction costs which cannot be met within the normal budget cycle. Short to medium-term **project financing** will therefore be used to **cover the transaction costs of reform**.

110. While managing the risks (principally procurement and audit) highlighted in AusAID's Assessment of National Systems (Annex 8), GfG will continue to provide **accountable grants** to competent units of government (and others) to take forward agreed policy and

institutional reforms. Some aspects of GfG's support to reform are best managed by the units of government or stakeholders involved, within their own structures, systems and—crucially—leadership. This has worked successfully with MFEM, and is about to be replicated with the PMO.

Estimated budget and timing

111. GfG was initially intended to run for 10 years, in two five-year phases: 2007-2012 and 2012-17. For internal AusAID budgeting reasons Phase II will in fact be budgeted for four years, from 2012/13 to 2015/16 inclusive, although provision is made in the final year for the design of a putative third phase.

112. The estimated total costs of Phase II, over four years, are shown below, and annual expenditure forecasts are provided in Annex 4.

AUD Australian dollars	Total
Program Management	
Core Staff, operational costs, advisers	**3,700,000**
Program Design	**200,000**
Performance/Evaluation	**225,000**
Managed Funds	
Prime Minister's Office	**3,000,000**
Ministry of Finance & Economic Management	**2,250,000**
Energy Sector	**1,000,000**
Aviation Sector	**500,000**
Telecommunication Sector	**2,730,000**
Knowledge, Analysis, Research, Briefing	**1,050,000**
Unallocated (Flexible Fund)	**8,700,000**
Total	**AUD 23,355,000**

Part 3: Implementation Arrangements

Management and governance arrangements and structure

113. GfG has established itself as a key platform for partnership between AusAID and GoV. It is a standalone project, with its own set of objectives, budget and staffing, but it is essentially an extension of Post embedded within government's operations.

114. GfG must exhibit extreme sensitivity to GoV's absolute prerogative in the management of policy processes, and—to be effective—must be able to respond adeptly and flexibly to emerging opportunities, some of which have very narrow windows of opportunity.

115. While GfG's remit relates specifically to Australia's support to Vanuatu's regulatory reforms and public expenditure processes, it will occupy a privileged position working with and within the top end of government, requiring tact, empathy for the challenges GoV faces, and above all the **establishment and maintenance of trust**.

116. For these reasons the Director of GfG should remain an '*Executive Level 2*' position in the Australian public service. It is entirely appropriate that GfG is directed by an AusAID official of some seniority, competent and credible in policy matters and able to commit the program where flexible support is needed quickly.

117. GfG is a part of Australia's bilateral country-program. It is the vehicle for delivering one of the *Australia-Vanuatu Partnership for Development's* four priority outcome areas[22]. That partnership is managed (for AusAID) by the AusAID Counsellor / Head of Post. **In terms of its accountability to AusAID**, GfG and its Director are directly responsible to the Counsellor / Head of Post.

118. GfG also reports to a joint ***GfG Management Committee.*** This ensures it **captures the priorities and perspectives of GoV**, and is equally accountable to GoV for its actions and progress.

119. The joint GfG Management Committee makes decisions about key program priorities, resource allocation and activity implementation, providing a forum for discussion of policy and program issues. The Committee ensures that both AusAID and key actors within GoV are involved in decision-making. It is comprised of Directors General of the Prime Minister's Office, the Ministry of Finance and Economic Management, and Foreign Affairs. The Directors General may nominate a senior representative to stand in their place (such as the Director of DSPPAC or Director of Finance). AusAID will be represented by the Counsellor and GfG will be represented by the GFG Program Director. These shall be the five voting members: any other attendees would be observers. (See below.)

120. In order to diversify representation, and in recognition of the breadth of the challenges faced in policy and institutional reform, the Committee may invite additional observers, including from civil society and the private sector. Other AusAID and other senior GoV officials may also attend as observers or to contribute on specific issues as required. The Committee will operate through both frequent informal contact and periodic formal meetings (at a minimum every six months). GfG shall act as the Secretariat for the Committee. The Chair will rotate each meeting amongst voting members (excluding the GfG Program Director).

121. Decisions on day-to-day management shall be devolved to the GfG Director. The GFG Director maintains the flexibility to authorise expenditure up to $250,000 from the Flexible Fund, which must be in-line with the agreed priorities of the program and be reported and scrutinised at the next Management Committee meeting. All GFG expenditure will also have

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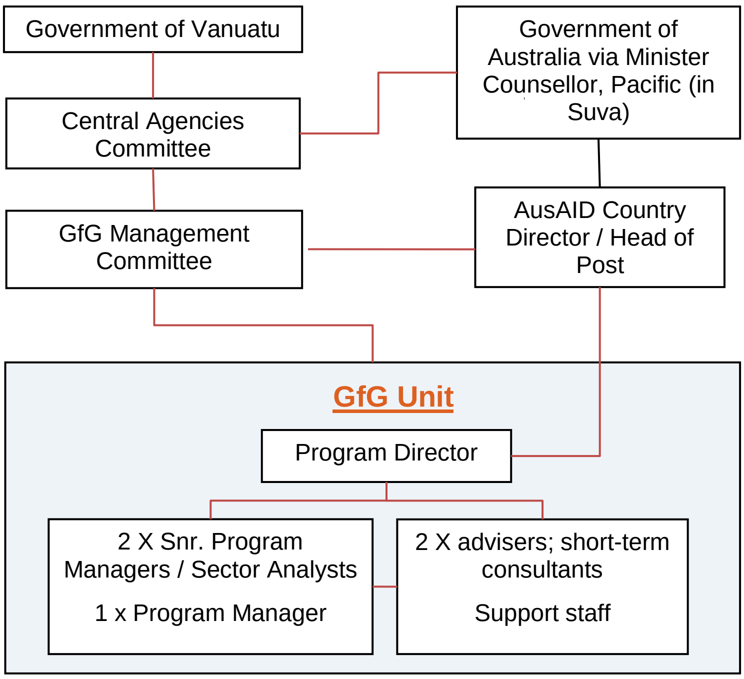
[22] Partnership Priority Outcome 4: Economic Governance.

to meet standard AusAID financial management requirements (which may include technical appraisal for high value or high risk proposals).

122. Matters which require higher-level endorsement within GoV will be considered by the existing Central Agencies Committee, with the AusAID Country Director attending to represent AusAID when required. Specific GfG-sponsored reforms may in turn be referred to other bodies in accordance with GoV's normal approval procedures: for example the Development Officials Committee and the Council of Ministers.

123. Figure 4 below outlines the overall management and governance structure (which is as per Phase I).

Figure 4: GfG Management Structure



124. The GfG Unit is housed in GoV office space provided by the Public Service Commission and adjacent to the Prime Minister's Office and the Department of Strategic Policy Planning and Aid Coordination. Colocation of GfG in this GoV compound (instead of in the Australian High Commission) is both symbolically and substantively important to the partnership, promoting frequent informal contact and the development of relationships between GfG staff and GoV counterparts.

125. The GfG unit also includes two ni-Vanuatu Senior Program Managers (SPMs), a Program Manager and an Administration Officer. Given the reduced emphasis on the more transactional elements of GfG's Phase I work, the design team's preference would be to call the SPMs 'Policy and Public Expenditure Analysts'.

126. GfG engages other sources of advice as needed. In Phase II it will employ specialists in macroeconomic analysis and in public expenditure management (Draft Terms of Reference at Annexes 5 and 6).

127. Terms of Reference for the GfG Director, other GfG staff and the Management Committee remain as per Phase I.

128. While the Phase II design team see this existing oversight and governance structure as being entirely appropriate in principle, an observation is that the Management Committee has in practice met only infrequently during Phase I. It is not clear why. Perhaps contact and dialogue provides sufficient confidence in GfG's management decisions. Or perhaps the

committee has focused on program management issues at too low a level to maintain the interest of senior staff. Proposed changes (para 97 and 98) seek to address this, but AusAID and GoV need to discuss this further and address concerns raised.

Implementation plan

129. Annex 10 summarises GfG's past interests and interventions and Annex 11 provides an indication of current / first year Phase II commitments and pipelines. There is no distinction to be made between Phase I and Phase II in terms of GfG's 'implementation plan', other than divesting management of the infrastructure program to other parts of the Australian bilateral program and sharpening the focus on the 'upstream' and 'downstream' issues described in Part 1.

130. GfG's portfolio of work and its scheduling is wholly responsive to policy windows and opportunities emerging from GoV's own agenda, within the mandate and framework described elsewhere in this document, and this Phase II design does not seek to prescribe an 'implementation plan' beyond that.

Monitoring & evaluation plan

131. Monitoring and evaluation of GfG's success and impact proved difficult in Phase I. This was at least in part because its performance frameworks were unrealistic and pitched at outcomes that were too complex, too difficult to measure and certainly difficult to attribute.

132. In Phase II, monitoring and evaluation will be more systematic. Periodic short-term inputs by an Independent Performance Adviser (included in Phase I) will be strengthened both in terms of time and funding allocated. The monitoring and evaluation plan will **consider outcomes and impacts at three levels**:

> **Level 1**: The impacts and outcomes attributable to GfG staff and resources
>
> At this level, success will be measured by the scope, scale and quality (relevance, efficiency, effectiveness etc.) of GfG's **policy dialogue** (Annex 9). This will include the quality of partnerships formed and coalitions fostered through GfG's advice, brokerage and facilitation.
>
> **Level 2**: The immediate impacts and outcomes of the changes that the GoV-GfG partnership brings about
>
> At this level, success relates to measures of '**good governance**': the attributes of the systems and processes (policy-making, public expenditure management, etc.) promoting equitable growth and service delivery. This will be assessed in terms of the **capability**, **accountability** and **responsiveness** of the organisations and institutions which GfG has supported or in which it has invested resources. (The so-called 'CAR' framework, Figure 5 and para 133 below.)

Figure 5: the 'CAR' dimensions of good governance

Source: Adapted from DFID/ODI – see para 133 below

133. The Capability, Accountability and Responsiveness (CAR) Framework (Figure 5 above), developed by DFID and others[23], provides simple clarity on the ingredients of 'good governance' and allows assessment of the various dimensions of governance. Used over time it allows for monitoring of governance performance and subsequent revision to the design of the form of aid.

- **Capability** is the extent to which leaders and units of governments are able to get things done and to perform functions such as providing stability, regulation, sound public expenditure management, trade, growth, effectiveness and security.
    - It will be measured in terms of change in organisational behaviours and success in fulfilling mandates.
- **Accountability** describes the ability of citizens, civil society and the private sector to scrutinise public institutions and governments and hold them to account to ensure transparency, free media, rule of law and elections.
    - It will be measured in terms of participation, the quality of networks, the quality of analysis and oversight (including parliamentary oversight), the quality of the engagement of the media, and citizens' involvement in local and national policy- and decision-making.
- **Responsiveness** refers to the extent to which public policies and institutions respond to the needs of citizens and uphold their rights, provide equitable access to services, pro-poor policy, equality, regulation and corruption.

[23] The 'CAR'(Capability, Accountability, Responsiveness) framework derives from DFID's 2006 White Paper 'Making Governance Work for the Poor' and was further developed by, for example, Plummer and Slaymaker in ODI's Working Paper 284 'Rethinking governance in water services' (2007)

- It will be measured in terms of public perception, transparency, the degree of space for civil society to generate and transmit its ideas and priorities, access to information, etc.

Level 3: Beyond the GfG partnership

Ultimately the success of the GfG partnership will be measured in terms of making a coherent, credible, effective, value-for-money, contribution towards institutional reforms that bring about faster, more equitable, growth and better quality, more accessible, services. Some of GfG's existing higher-level performance measures may still be appropriate here, but need to be tailored to the anticipated impacts of specific activities and interventions on which GfG and GoV have been working.

134. A basic program logic, and how each stage might be measured, is shown on the next page.

135. A more structured approach to monitoring and evaluation needs to be instigated in Phase II, for which increased budget resources have been scheduled. Periodic short-term inputs by an Independent Performance Adviser (draft Terms of Reference at Annex 7), as envisaged in the Phase I design but not implemented, should:

- Develop a performance monitoring regime (including establishment of baseline data), and monitoring frameworks for each sub-program, for implementation by GfG's Senior Program Managers / Policy & Sector Analysts;
- Guide and mentor the Senior Program Managers / Policy & Sector Analysts in performance management;
- Undertake annual assessments of performance against the first and second levels described above, in the main based on using monitoring data assembled by the Senior Program Managers / Policy & Sector Analysts.

136. An Independent Progress Review should be undertaken in the third year of GfG Phase II, sufficiently resourced to collect data and evaluate progress up to and including Level 3.

Program logic

GfG constitutes a catalyst and platform for ***effective policy dialogue*** so that sound, locally-owned, evidence-based **policy and public expenditure choices** are **made** and **managed**

GfG provides flexible and responsive support and funding to drive quality policy processes and improve public expenditure management

Better policy and public expenditure choices result in strengthened **'governance'**, in terms of the **capability**, **accountability** and **responsiveness** *of the organisations GfG is supporting*

Good governance results in institutional ('rules of the game') **reforms** that bring about faster, more equitable, **growth** and better quality, more accesible, **services** for citizens

Measures of performance

AusAID deliverables

Extent to which GfG pursues **best practice in policy dialogue** - refer to ODE's 2012 Evaluation of Policy Dialogue in AusAID (summarised in Annex 9)

* Flexibility and responsiveness

* Relationships and trust

* Investment in building GoV's negotiating capital

* Sensitivity to political economy

* Extent and quality of coalitions

* Breadth and depth of forums

* Generation and appropriate use of evidence

* Staffed by 'policy entrepreneurs' with skills and credibiity

GoV/Aus GfG partnership outcomes

* Extent to which leaders and organisations are able to get things done and perform functions such as providing economic stability, regulation, trade/growth, public financial management

* Ability of citizens, civil society and the private sector to scrutinise public institutions and hold them to account

* Extent to which public policies and institutions respond to the needs of citizens, including access to basic services, pro-poor policy, equality, regulation and freedom from corruption

Impacts

Extent and significance of *new public and private sector behaviours* and how those *changes* contribute to:

* More robust, less volatile and generally positively-trending economic growth

* The equitability of the flow of benefits from growth

* Quality and accesibility of basic services, particularly for the:

- majority rural population
- urban poor

Procurement arrangements

137. Procurement has thus far been managed by GfG using local AusAID procurement processes, GoV systems or a combination of the two, according to the nature of the specific activity. The original program concept anticipated the transfer of full responsibility for TA recruitment and management to GoV. This will remain a long-term goal. However, at present there is limited capacity or interest in GoV partners to take on the recruitment and contracting role and most selection processes continue to be undertaken by AusAID in consultation with GoV.

138. GfG will provide support to strengthen GoV procurement systems to help build capacity to take on this responsibility. The recent Assessment of National Systems highlights the need for this kind of support. Capacity will also be enhanced through the active involvement of GoV partners in GfG procurement exercises: in all cases, GfG will maximise GoV involvement in and leadership of procurement, while continuing to provide the administrative support necessary for a timely and consistent process.

139. GfG will continue to conduct some procurement in-house, especially that which is particularly sensitive or urgent.

Sustainability

140. The extent to which there will continue to be a flow of benefits after program support finishes (the definition of *sustainability*) is considered high (with some caveats about infrastructure—see below), for a number of reasons:

- GfG is wholly and explicitly supporting the policy priorities of the Government of Vanuatu, so one can expect a high degree of ownership of the initiatives supported. And higher levels of ownership usually translate into higher levels of sustainability.
- GfG is focussed on supporting *transformative* investments: changes to the policy, regulatory and public expenditure choices in support of broad-based growth and service delivery. Such reforms are generally structural, impact the wider population and will have lasting effects on the economy. GfG is not involved in transactional investments where the continuation of benefits depends solely on continued funding.
- GfG works within, and is ultimately governed by, existing GoV structures and systems.
- Part of GfG Phase II's work will be to examine the imbalance that potentially exists between the recurrent and capital budget, particularly the maintenance costs of the current very high level of infrastructure investment. While this imbalance is a concern for the sustainability of current infrastructure investments, the outcomes of this analysis—and any shifts in public expenditure (including the configuration of aid flows) that come out of it, should promote sustainability.

At a lower, program-management, level there are concerns about the extent to which GoV drives and feels it owns important processes such as the prioritisation and oversight of GfG's work program. Revisions to the structure and function of the GfG Management Committee are currently being discussed which may go some way to address this. However, more fundamental, institutional, reasons for the difficulty sometimes experienced in locating the real demand for policy and public expenditure reform, and how GfG can best help, also need to be addressed, as discussed at paras 46 to 49 and 56 to 58 above.

Crosscutting issues

Gender

141. GfG Phase II objectives re-emphasise the importance of the equitability of development outcomes: *i.e.* securing a more equitable distribution of benefits of growth and equitable access to services. **Gender disparities** in the distribution of the benefits of growth and in access to services, and more fundamentally in exercising voice, leadership and power, are significant issues in Vanuatu[24], as they are across the Pacific more widely. GfG clearly has an important role to play in addressing them.

142. AusAID's draft strategy[25] for achieving Pacific gender equality aims to see that:

- Women and women's interests are increasingly represented, effective and visible in leadership positions at all levels;
- Women have expanded economic opportunities to earn income and accumulate economic assets;
- Violence against women is reduced and that survivors of violence have access to support services and to justice.

143. GfG, with its unique positioning, focus and governance interests, thus has a pivotal role to play within this strategy in analysing, understanding, highlighting and supporting policy, regulatory and expenditure reforms that help to address gender disparities. Through policy engagement and knowledge management GfG will be an advocate and a resource for greater gender equality at the most senior levels of Government.

144. The nature of GfG's involvement will depend on the policy and public expenditure issues being debated. But it will certainly be about:

- Moving the topic more centrally to programming and policy engagement;
- Clearly tabling Australia's values and interests in gender equality through formal and informal policy dialogue (and with the management committee);
- Being held to account by AusAID as regards being clear and confident about what the gender issues are for any engagement (at a minimum);
- Developing credible actions to ensure equality is targeted in what GfG does as a result.

145. This has to be part of more assertive GfG positioning on gender, and it also has to be central to GfG's monitoring and evaluation and its narrative about its seeking to influence change.

146. GfG will include women in all consultation processes and include women in any reference group where it is possible to do so, and it will gender-disaggregate all data collected as part of its analysis and will encourage GoV to do so wherever possible.

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[24] There is, for example, just one woman among Vanuatu's 52 parliamentarians, and Vanuatu ranks below the developing-country average for gender parity in tertiary education.

[25] Pacific Gender Equality Initiative Draft Delivery Strategy 2012-2022: 'Pacific Women Shaping Pacific Development'.

147. It should be acknowledged, however, that GfG can only play a part in what has to be a more explicit and comprehensive program-wide policy dialogue on, and strategy for, its engagement on gender issues in Vanuatu. That is yet to emerge.

Corruption

148. As highlighted elsewhere, the political economy of policy and investment choices in Vanuatu is complex and on the face it of sometimes involves corruption. Clearly GfG has an important role to play in promoting and supporting sound, transparent and evidence-based policy-making, and robust public expenditure management, and has been successful in so doing.

149. However, there are more subtle aspects to policy development in such an environment, where the boundaries between overt corruption and the norms and expectations of a strongly patrimonial society are difficult to define. As discussed elsewhere, GfG can help promote more genuinely open and evidence-based policy decisions by actively building and helping to equalise the 'negotiating capital' of key stakeholders, such that they are able to assess and present their positions more clearly and have greater ownership of the evidence on which robust policy and public expenditure choices are made.

150. GfG's form of aid and tightly monitored use of modestly-sized accountable grants to competent agencies, within a generally sound public accounts capacity, is assessed as presenting some but very little fiduciary risk.

Child protection

151. GfG and its staff have no direct involvement with children, other than in the promotion of sound, fair and equitable policy.

Climate Change

152. Vanuatu is among the most vulnerable countries in the world to climate change. Potential impacts range from decreased productivity from farming and coral reefs to increased risk of damage from more severe cyclones. While AusAID's assistance is likely to remain focused on increasing the resilience of infrastructure, and therefore responsibility for Climate Change program delivery will move outside GfG, Phase II has an important role to play in ensuring that consideration of the impacts of climate change are being addressed in the development of medium and long-term policy planning.

Disability

153. Disability is often overlooked in the consideration of national policy globally. GfG will consult Vanuatu's disabled community in the development of its activities wherever possible. GfG should consider undertaking a disability analysis to inform its interventions, and will promote greater consideration of the rights of disabled person in the development of reform.

Civil Society

154. In Phase II GfG should seek to engage more with civil society than it has been able to in the past. The transition of program management responsibilities will free up time to engage with a wider network of stakeholders. Civil society in Vanuatu is poorly organised and lacks strong influence in Government. GfG should encourage greater participation from civil society organisations in the development of policy and should seek to include representatives from civil society in policy dialogue where the occasion permits. NGOs and the private sector should be considered important stakeholders in the policy process. The inclusion of a civil society and a private sector representative on the management committee is the first step in a long term process to encourage greater civil society participation in policy planning and development.

Compliance with the Financial Management and Accountability Act

155. The GfG Director reports to the AusAID Country Director (the Counsellor), who is also involved in higher-level policy and programmatic discussions with GoV (for example where issues have broader implications for the aid program) and is ultimately responsible for Australia's aid program in Vanuatu. The Counsellor holds Australian Government delegations under the Financial Management Act (FMA) and therefore provides the requisite FMA approvals (up to her or his delegation) for GfG procurement, contracting and expenditure.

Compliance with the Environment Protection and Biodiversity Conservation Act

156. In divesting its responsibility for infrastructure GfG will have much less direct involvement in environmental matters. However, sound environmental analysis forms an essential consideration in all policy and public expenditure choices, and will continue to be championed by GfG.

Critical Risks and their mitigation

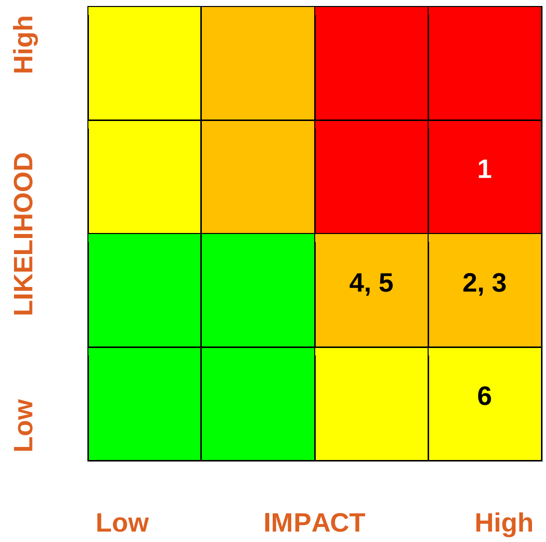
157. A number of risks were identified in the original design document which remain: political and administrative changes and instability, international economic developments, the complex interactions of political, commercial and technical priorities, absorptive capacity.

158. However, these are 'certain uncertainties' which any government and any program of support to strengthening governance will have to deal with. By virtue of the fact that GfG is, as emphasised at the beginning of this document, all about helping Vanuatu overcome economic inefficiencies by strengthening the processes and structures of governance, it is by definition helping Vanuatu accept and deal with such risks.

159. In the design team's view, GfG does not, in fact, constitute a particularly high-risk project, provided its unique role, mandate and responsibilities are understood and managed. Relinquishing infrastructure program management is a risk management measure. It will allow the team to focus on building awareness of GfG's role and enable them to manage the risks of policy intervention and institutional change more effectively.

160. A risk matrix and mitigation strategies are provided on the following pages.

161. Critical risks are assessed as follows:



Highly significant Requires strategic management and may warrant redirection if not resolved		
No.	**Risk**	**Management & Mitigation**
1	Imbalance between the recurrent and capital budgets, largely attributable to the configuration of aid flows, represents significant macroeconomic, capacity and long-term sustainability risks.	GfG Phase II contains a new focus, and new advisory capacity, on macroeconomics and development policy.

Moderately high significance Requires specific mitigation measures and monitoring by management above the level of the program		
No.	**Risk**	**Management & Mitigation**
2	Trust between GoV and GfG breaks down due to external political tensions, or loss of credibility with / value to GoV.	Mature, expert, understanding of the political economy of policy-making in Vanuatu ingrained in GfG's ways of working and staffing. Post explicitly recognises the trust and confidence GoV places in GfG.
3	Notwithstanding improved public expenditure management, the recurrent costs to government of adequate quality/quantity of service delivery prove unaffordable in long term.	Understand better through cost-of-service-delivery analyses. Attention to balance between capital and recurrent budgets.
4	Loss of focus on the transformational; 'governance' too broadly interpreted; GfG over-stretched by additional spend-related responsibilities.	AusAID clear about GfG role and mandate (as set out in this design) and avoids using GfG as a vehicle for broader program-delivery.
5	Fiduciary risk - misuse or misappropriation of funds under all grants, or in any of the activities support by GfG under the 'flexible fund'	Independent audits (by external accounting firms) of all grants to be commissioned by GoV or GfG every two years and audit program to be carefully considered for all other activities. All grant agreements to include robust and specific provisions for reporting and acquittal. Monitoring of all procurement by GfG and the recruitment of procurement and financial management advisors in institutions where risks or misappropriation is judged to be high. Further actions to be taken as necessary in line with the ANS and noting GfG's ongoing role in improving Public Expenditure Management across government.

Moderately low significance Requires monitoring and if necessary management from within the program		
No.	**Risk**	**Management & Mitigation**
6	Insufficient attention to decision criteria for entering and exiting activities and lack of ongoing monitoring and evaluation prevents GfG/GoV from ‘managing for results’ and focusing on areas of greatest potential impact	Diligent allocation of appropriate resources to establishing and maintaining a performance management system.

Annex 1: Overview of Development Challenges in Vanuatu, 'Governance', and GfG's role

The wider political, economic and social context

Vanuatu remains a lower-middle income country with per capita income around US$2,900[26], although average incomes have doubled since 2002. Economic reform over the last decade contributed to a period of sound fiscal management and economic stability with moderate inflation and relatively strong growth in absolute terms[27]. The global financial crisis caused growth to slow and contributed to increasing, though manageable, fiscal deficits. Vanuatu has fared better than many of its neighbours through this period and continued with steady progress on economic reforms. However, political instability from late 2010 has threatened to undermine some of this progress and has brought into sharp focus the need to bed-down critical GoV-led reforms and seize any opportunities that arise for further change.

Unfortunately, consistent growth has failed to translate into jobs and services for most of the population. The gains that have been achieved have centred on Port Vila. Near-subsistence agriculture still sustains livelihoods for 70% of the population, with less than 15% of the population involved in the formal economy[28]. Low levels of economic activity and an ineffective tax system mean limited government finances and investment without donor support.

Vanuatu's political environment is described in the 2007 *Drivers of Change* report[29] as unstable and fragmentary, with political competition based on patronage rather than competing policy platforms. It has been characterised by fierce infighting within unstable coalitions, with 16 changes in government in the 13 years leading up to the 2004 elections, and five changes of government in the last 18 months. Political instability hampers bureaucratic capability and compounds perceptions of government mismanagement.

Political institutions are modelled on the Westminster system, but these are guided by systems of patronage based on complex traditional relationships of reciprocity between leaders and their communities. Most politicians are elected in rural areas by electorates of 1000-2000 people. As a result politicians in Vanuatu are under constant pressure to provide direct, material benefits to their constituents in exchange for their support. These factors generally lead to a high turnover of MPs at every election, which in turn leads to short-term and narrow thinking about the public interest and low levels of political accountability.

Given its size and capacity constraints, Vanuatu has built reasonably strong judicial, financial and public service structures over the three decades since independence. These provide a sound governance base from which to support the development of the nation state, but many gaps remain. Major reforms, most notably the Comprehensive Reform Programme of the late 1990s have helped to develop a core of proficient and professional public servants who understand the constraints to growth and development, but are themselves hampered by chronic resource limitations across government (up to 30% of positions are currently unfilled – 313 positions in 2007). The administration remains critically dependent on a few key individuals to function effectively and the rate of new graduates entering the public service is low. New institutions continue to be created without sufficient regard to the availability of qualified staff to fill them, stretching the limited human capacity ever more thinly.

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26 IMF World Economic Outlook Database, September 2011.

27 Pacific Institute of Public Policy, Vanuatu Country Profile, www.pacificpolicy.org/country-profiles/vanuatu

28 Drivers of Change, 2007

29 'The Unfinished State: Drivers of Change in Vanuatu', Marcus Cox et al, 2007. www.ausaid.gov.au/Publications/Documents/vanuatu_change.pdf

However, there are specific institutional units capable of producing evidence-based policy. The most effective initiatives tend to come from individual ministries up through the budget process. The annual budget provides an opportunity for civil servants to provide technical analysis to politicians on policy choices, and for discussion of departmental performance. Policy-making is at its weakest in multi-annual planning and cross-sectoral prioritisation. Pressure from donors to produce comprehensive development strategies has produced documents with limited ownership across the administration.

Many of the development challenges that faced Vanuatu when GfG began in 2007 remain today. The key short- and long-term constraints on growth identified in the initial GfG program design have only been partially addressed:

Government service delivery has limited reach outside the capital and generally what does reach rural areas is of poor quality. For example:

- Only 17% of the population has access to electricity;
- Skilled birth-attendance rates are is as low as 32% in the outer provinces;
- Only 20% of the health budget is allocated to the provincial and community level, despite having 70% of the population;
- Nine out of ten children are failing to meet minimum literacy standards at the end of Grade 3;
- Infrastructure coverage and quality remains poor, and transport expensive and inter-island sometimes unreliable, adding to the cost of many economic and social activities.

Apart from primary schools and first-aid posts, most ni-Vanuatu derive little direct benefit from government. The six provincial governments are under-resourced and largely unable to deliver services. There is little coordination between the provincial administrations and central government departments. The 63 Area Councils, the lowest formal level of government, have only a single employee each, and the provincial structure is weak: at present four of the six provincial councils are suspended as a result of poor performance and the remaining two look shaky.

By contrast, customary and informal institutions at local level are seen as legitimate and relevant to people's lives. However, their capacity to support community development is limited. Chiefs continue to be the main authority at community level, especially in law and order. The churches are also active participants in community governance, providing a range of services, particularly for women, youth and the vulnerable. NGOs also have the potential to influence policy and national development, but at present civil society outside the churches and the chiefs remains poorly coordinated and only marginal in its power to shape the national debate.

Corruption is a major issue in Vanuatu and shapes the realpolitik of policy and institutional reform. Dispensing resources is seen as a legitimate means of obtaining status and influence and/or a requirement of an elevated position. As a consequence, the formal accountability institutions—Parliament, the Auditor General, the Ombudsman—have often proved to be ineffective. The challenge remains to find an effective means to manage the impact of corruption on policy processes. But corruption needs to be viewed through the lens of the patrimonial system, as a systemic problem rather than simply individual misconduct, and programs supporting policy development and implementation need to recognise and work with this.

While some progress has been made in most components of Vanuatu's Priorities & Action Agenda (PAA) sectors, and in the important cross-cutting areas (macroeconomic stability, public sector reform, infrastructure), there are apparent weaknesses in capability to implement PAA programs in many areas. Performance is falling behind aspirations on some key outcomes. (Four of the Millennium Development Goals are unlikely to be met: 1, 3, 5 and 7 – i.e. sustainable growth, private sector development, rural service delivery, and some aspects of governance). The PAA and PLAS strategies need to be refreshed to reconsider the priorities or to promote greater thought and effort in implementation in areas that are lagging. This requires some agreement about why these results have fallen behind the aspirations.

Plans and policies

The 2007 Drivers of Change analysis highlighted the challenges is setting a framework for development planning:

> *"... within a short period of time, the PAA came to reflect the same set of flaws as the CRP. Weak oversight by DESP and multiple, poorly coordinated inputs from donors, against a background of political instability, meant that prioritisation proved impossible, and the document became a parallel national strategy of nine chapters, along the lines of a Poverty Reduction Strategy Paper. The PAA was not prepared by reference to a medium-term budget framework, and has therefore become another vision document that would need to be prioritised before it could be implemented."*

Despite good progress in some areas, there remain weaknesses in governance, policy making, budgeting and public management, which are holding back the development of Vanuatu. There are also distortions caused by the aid flow. These matters affect the flows of public resources and the incentives and regulations that control both public and private sectors. But the overwhelming cause of underdevelopment is crippling shortages in the capacity across the public and private sectors that is needed to support a modern economy.

Formal development plans at either national or sector levels have not and will not alone overcome these weaknesses. They need to be addressed directly in an agenda of initiatives that strengthen the fundamental institutional frameworks upon which development depends, and the major capacity constraints on progress. Some of these sit within sectors but many run across the whole economy.

Sector strategies and programs (for example Education Sector Support Program documents; Health Public Expenditure Review) will be far more effective if there is more progress on the cross-government issues of macroeconomic stability, an enabling commercial environment for business development, better governance and public management, more effective development planning tied to better processes of resource allocation, and improved policy dialogue both with external development partners and internally. The sector strategies and the programs to support them are mostly undergoing reviews at present, which should include consideration of constraints beyond the sector silos that must be removed for success.

The conclusion is that such cross-cutting issues should provide the backbone of the mandate for GfG II.

Reflecting on 'governance'

The global discussion on governance emphasises corruption, and institutional reforms that can combat it through increased transparency and accountability. Low capacity, lack of domestic revenues, terms of trade etc. all contribute to poor outcomes. Also the lack of effective policy frameworks does not seem to be due to a lack of reports written about what the policies should be. Well-governed countries sometimes do not spend enough on infrastructure. In Vanuatu in 2010 the Government ran up expenditure in ways not consistent with fiscal sustainability, but at a time when the budget and financial system was demonstrably being improved.

Better governance provides no concrete assurance of better decisions—just better informed decisions.

The Governance and Accountability Partnership concept paper (2006) set out the objective for the Australia-Vanuatu partnership as *"A more effective Government of Vanuatu to improve stability and the welfare of the general population"* and the proposed Purpose was:

> *"Improved service delivery and foundation for economic growth through strengthened" through:*
>
> - *Leadership;*
> - *Policy coherence and implementation;*
> - *Planning and resource management; and*
> - *Accountability and transparency of government.*

This expression of purpose remains relevant today and avoids unproductive discussion over what is governance and what is not.

GfG's role

The conclusions from the two preceding sections support the conclusion that GfG's interventions should not be confined to governance activities, although much of it will warrant this description. The core of its activities should be on cross-cutting issues with the objective of building stronger and more effective institutions—interpreted as the 'rules of the game', not as organisations. Examples would include the budget process, telecoms regulation, commercial law etc.

The role that GfG has played thus far is consistent with this conception of its mandate. Its work in building the budget and finance system and establishing regulatory institutions in telecommunications and electricity and helping to organise the capability to operate these fits well with the mandate. In the area of infrastructure it can be argued that it has gone too far in supporting transactions and should have built the capacity for these elsewhere and moved on. But this might not have been a practical possibility and the work had to be done.

A little pragmatism around the edges of the mandate that permits going hands-on in circumstances where practical considerations warrant this is desirable, but will usually come at a cost of being diverted from getting on with the next items on the core of the agenda.

Conceptualising performance

Setting performance expectations for GfG should follow good practices in public management for the attribution of results to the impacts of the various factors that influenced that result. The higher the level and expression of the desired outcome the less it is generally possible to attribute results to particular contributions. For example a finance ministry can be held accountable for accuracy in accounting reports and the quality of advice and information provided to ministers who make the budget decisions. But its performance on these indicators is only a partial contribution to fiscal outcomes and even less significant for the impact of fiscal outcomes on the economy. Ultimately the strength of a finance ministry does have an impact on a country's economic performance and some credit is usually due to the finance ministry in a country with a persistently well-performing economy. The reverse is commonly true also.

GfG should be held to account for efficiency in the use of its resources and effectiveness in delivering results. It should be open about what it intends to achieve and be accountable for the impact its activities have on the institutions and organisations it set out to improve. But the high level results sought by GfG are best interpreted as a joint performance indicator of the collection of influencers on the outcome. At that high level, factors over which none of the local players have influence may drive the outcome. For example, GfG can take credit for its role in the policy advice and follow-up implementation of the independent regulators in telecommunications and electricity. But it is not accountable for the performance of the regulators nor for the political pressures on those regulators.

Annex 2: Discussion of GfG 'Result Area 1' – Vanuatu's policy framework more supportive of durable, equitable and broad-based growth

Macroeconomic policy

The latest IMF Article 4 report, states that Vanuatu "…benefits from good macroeconomic fundamentals" and is "well placed to manage these macroeconomic challenges".

On the face of it, this is a satisfactory assessment of macroeconomic management. While the economy is weathering the global financial crisis in reasonable shape the IMF analysis also highlights areas of concern and in which the GfG could play a useful role in terms of analysis and advice.

- A moderately overvalued exchange rate (8-13%) – the correction of which is resisted politically;
- Weak revenues and the need for major tax reform;
- The need for continuing expenditure restraint for macro stabilisations reasons;
- Inflation driven by food prices;
- Too much liquidity in the banking system;
- Volatility in tourism volumes and donor-financed capital expenditure.

> "In overall macro-economic terms, Vanuatu has performed relatively well having recorded several years of positive [absolute] growth. Growth slowed down slightly in 2010, due to the flow on effects of the Global Economic Crisis and revenue collections being weaker than forecast, however the economy has shown signs of picking up this year with forecast GDP growth of 4.3 per cent in 2011.
>
> While the economic situation remains positive overall, growth in the agriculture and tourism sectors has been weaker, with major donor-funded construction projects (e.g. VTSSP) being the main driver of growth over the medium term."
>
> *GfG Sep 2007 - Dec 2011 Program Review, p.15*

Fiscal policy

Fiscal policy has both macroeconomic and microeconomic impacts on development. Under GfG's 'Result Area 1' the focus of fiscal policy is on macroeconomics. The microeconomic issues in fiscal policy are taken up under GfG's 'Result Area 2'.

The overriding goal of fiscal policy should be to assist in the stabilisation of the economy overall and enhancing its resilience to shocks. As the IMF notes "maintaining large fiscal, external, and financial buffers will help Vanuatu's economy be more resilient to shocks. On the fiscal side, this will require the government to mobilise revenue, facilitate smoother donor financing, reduce the wage bill, and improve state-owned enterprise efficiency and transparency. On the external side, the government should be vigilant in keeping its foreign reserves at an adequate level. In the financial sector, banking supervision should be intrusive and the regulatory framework and supervisory skills should be strengthened.

The questions of the efficiency of state-owned enterprises, the wage bill and mobilising revenue are specialised issues requiring particular expertise, which is unlikely to be found in an individual adviser. However the performance of the macro-economy indicates a need for attention to economic management at this level. Well-crafted microeconomic policies will be rendered ineffective by poor macro management, which is usually manifest in inflation, exchange rate instability, debt management problems, volatility in asset prices—commonly real estate—and employment. These symptoms of poor macro management erode the international competitiveness of the economy and discourage investment in productive business activity.

International competitiveness

This assessment points to the need for focused attention on macroeconomic stabilisation and maintenance of the competitiveness of the Vanuatu economy. In technical terms this concerns the real exchange rate and the need to keep the economic policy framework focused on maintaining a level that is growth-promoting – through a low-inflation monetary policy, backed by cyclically adjusted small deficits or surpluses in fiscal policy and microeconomic policies to promote business development and innovation.

The economy is being sustained by the construction sector, driven largely by aid flows. With high liquidity and high property prices and rents there is some risk of unsustainable growth in the non-traded sectors of the economy, while at the same time the traded sectors on which sustainability of development depends are inhibited by an overvalued exchange rate, competition for resources and compression of public expenditures that might otherwise have stimulated development of the traded sectors in agriculture, tourism and other products that can compete at intentional prices—either in the domestic or international markets.

A specialist adviser with the skills to work at a senior professional level on macroeconomic policy (fiscal and monetary policy, and financial markets) should be recruited by the GfG to work on these issues together with other economic development policies noted below. This specialist must be able to work effectively with the Reserve Bank as well as play an important role in creating a better macroeconomic framework for fiscal policy in the MFEM. Draft Terms of Reference for this specialist are provided as Annex 5. This role should also cover specialist skills in economic development policy and private sector development.

Private sector development

The development of the private sector has been substantially led by the construction industry which has been supported in part by aid-financed infrastructure. This is not sustainable. Sustainable development requires capable business services providers (accountants, mentors, technical advisers, business advisers etc.), entrepreneurs backed by equity participants who manage their risks wisely, commercial legal infrastructure that operates transparently, predictably and efficiently, competent financial intermediaries and more.

The growth of the indigenous SME sector of the economy has been below aspirations. The data and reporting from the Chamber of Commerce for example show disappointing results. (Figure 6 below.)

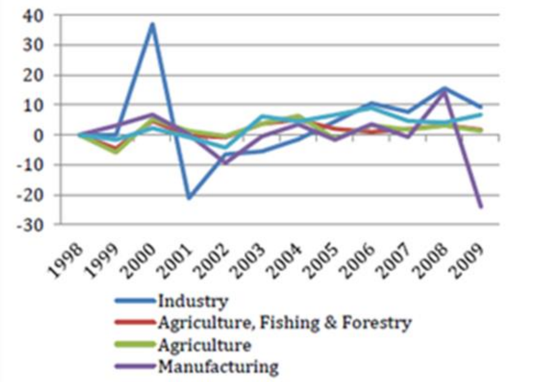
> "Growth has failed to translate to jobs and services for most of the population. Those gains which have been achieved have centred on Port Vila. Near-subsistence agriculture sustains livelihoods for 70% of the population, with less than 15% of people involved in the formal economy.
>
> "Low levels of economic activity and an ineffective tax system means limited government finances and economic investment without donor support."
>
> *Design Concept Note*

SMEs are very vulnerable in any country and their failure rates are high. Their health is not dependent on special programs of support but on a comprehensive business environment that provides fertile soil for the seeds of small scale entrepreneurship.

In Vanuatu, in common with many developing countries, property rights must be better defined and governed in informal or formal institutional frameworks that promote innovation, investment and risk-taking, and productivity improvement. SMEs are not well connected politically, their balance sheets are small, their access to credit is limited, they can't spend a lot on marketing or R&D, and their managers may not have much capacity for managing finances and business risks. They are often the creations of particular individuals and so these businesses are vulnerable to any weaknesses in the capability of these individuals. SMEs cannot afford lawyers to manage their contractual risks; they are vulnerable to downstream monopolies, well-connected merchants and loan sharks.

So SME progress is a performance indicator of the health of the whole commercial environment. It shows whether entrepreneurs without connections and protections can succeed. The fact that progress is slow indicates that there is work to be done.

Figure 6: Growth rates in selected sectors



Source: Nation Bureau of Statistics and the Central Bank of Vanuatu

Information submitted by Vanuatu Chamber of Commerce

The Ministry of Trade has developed a trade policy framework that should be considered as including possible areas of activity for GfG.

Expanded GfG role in macroeconomic policy and development strategy

Core activities of GfG's new Macroeconomic Policy Adviser should be to provide the macroeconomic analysis and modelling to support a multi-year fiscal strategy that integrates capital and current expenditure. This includes careful analysis and advice on the macroeconomic and distributional implications of the flow of resources from donors.

This person and the GfG as a whole should work with the Reserve Bank, the PMO and MFEM to provide a hub around which leaders from business, government, donors and civil society can gather to discuss issues of economic development and come to understand the issues and trade-offs that must be faced.

The **initial priorities** should be:

- Examining the scope and quality of the macroeconomic analysis underlying the fiscal forecasts and making proposals to improve it;
- Working with the PFM specialist to support the development of a medium term fiscal framework;
- Working with the PFM specialist to examine distortions to macroeconomic stability and development strategy from the donor flows and the budget system;
- Analyse the distributional implications of the macroeconomic policy, development strategy and market trends in terms of rural-urban distribution and impacts on poverty;
- A study of private sector trends and development policies with a view to contributing to a strategy for stronger private sector development.

Annex 3: Discussion of GfG 'Result Area 2' – The quality of Vanuatu's public expenditure and its management is improved

The quality of public expenditure is taken to include a fairly wide range of features of the public sector management system that have an impact on the results achieved through the expenditure of public money. So while there is an emphasis on budgeting and financial management, drawing on the findings of the Assessment of National Systems (ANS) (summarised at Annex 8), GfG will need to address a broader landscape of issues in public sector management if it is to assist the authorities to raise the quality of public expenditure.

The public sector reform program needs to build on past achievements and make vigorous new efforts in connecting the central administrative processes of governance and management to the management systems in ministries and on out into the provinces and service delivery units. A medium term fiscal framework is needed that integrates current and capital expenditure and links money transparently to programs and processes for achieving better outcomes. Good procurement processes need to be developed and entrenched. Internal and external audit functions need to be developed and improved and the role of the legislature in oversight of the Government needs strengthening.

Strengthening financial management

The recent Assessment of National Systems provides an up to date report card on the financial and budgetary system and so it is sensible – indeed imperative – that the GfG adjust its previous role in financial management and regulation to address the weaknesses and build on the strengths identified in the ANS to drive the system to higher levels of performance. This will make progress feasible on the general partnership commitments to greater use of partner government systems and provide the systems needed to resolve distortions in fiscal allocations (see below). As the ANS states:

> *AusAID's planned expenditure for 2011-2012 is A$53million or VT4.8 billion, which compares with the 2011 budget forecast for 2012 of VT21 billion, or approximately 23 per cent. Other donors are proposing another VT2.2 billion according to the 2011 budget forecast so that a total of 33 per cent of budgeted spending is financed by assistance grants. The narrow tax base of Vanuatu is producing a budgeted VT14 billion and cannot support heavy spending on vital sectors like Health and Education while also providing for the maintenance of rapidly expanding public infrastructure. At this level of spending by donors the need for PGS that can securely and effectively manage this flow of funds is obvious and urgent. The key issue is how to support the development of the required capacity for wider use of PGS as fast as is reasonably achievable.*

The ANS identifies various fiduciary risks and makes recommendations regarding criteria for the greater use of national systems. Its key conclusions are variously quoted and summarised in the following paragraphs (indented), with more detail provided in Annex 8.

> *Tax administration needs to be greatly improved. From the donor perspective the lack of a robust and growing domestic revenue flow must be a concern, especially regarding the funding of the maintenance of donor funded infrastructure.*
>
> *The 2008 financial management reform plan had eight objectives and progress has been made on these. Notably the financial management information system (FMIS) has been made available on line to ministries to support and discipline their financial management. Also Financial Service Bureaus (FSB) are being installed around the country to enable decentralised access to systems and information.*
>
> *The MFEM has done well in building capability and managing its role in those areas of financial management where it has strong influence because it is fully responsible for those systems. Further, these 'upstream' systems are about presentation of budget and*

financial information, whereas the fiduciary risks of PGS are mostly 'downstream' in areas of budget execution, controls and audit within a framework of decentralised management.

The upstream systems are well short of best practices in medium term expenditure planning and management – although the system operates efficiently through the annual cycle. From a donor perspective this means that multi-year projects and projects that cross fiscal year boundaries are not captured in the upstream systems in ways that promote clarity and better decision on a multi-year basis. In particular the ongoing maintenance expenditures from donor supported infrastructure projects are not properly allowed for. It is recommended that in respect of upstream systems donors promote and support improvements in these and in particular, over several years, the development of a multi-year fiscal planning framework that integrates current and capital expenditures and allows for donor support for current as well as capital expenditures.

The classification systems and conventions for the budget and accounting systems are acceptable but will be insufficient for donor accountability and management purposes in specific areas. These will require additional information.

The lack of coverage of off-budget entities and contingent liabilities from Government Business Enterprises (GBEs) and local government is rated as a high risk, although the impact on donor fiduciary interests is largely through the aggregate fiscal risk these create and not a direct risk to donor projects except where these off budget entities are specifically involved.

Poor legislative scrutiny of budgets, accounts and audit reports is a high fiduciary risk for donors – especially in light of the weakness in the audit function. Essentially the Parliament is doing poorly in holding the executive to account for the use of GoV and donor monies.

With regards to the downstream systems the weaknesses are more serious and present greater risks to donors.

The greatest weaknesses and associated fiduciary risks are consequent in large measure on the decentralised system of financial management. These risks appear upstream where non-compliance and errors with information requests from MFEM to the ministries can compromise budgets and accounting reports. And they appear downstream, especially in the procurement system and in the lack of internal audit and assurance functions in line ministries and service delivery units. Internal controls on non-salary expenditure in ministries are also an area of weakness.

The major weaknesses and risks are in procurement where the diagnostics and supporting information show that the system is not operating to a standard where donors should use it without taking very high levels of risk and/or continuing to require additional steps in the processes, and controls to manage those risks.

The lack of internal audit and assurance processes across the ministries is a second major area of weakness and risk. Without these the regulations that are by and large acceptable – with some exceptions – are not being complied with, or there is no assurance of such. The MFEM is launching a substantial initiative in internal audit, which is to run across the ministries. Strong support should be given to the MFEM's endeavours to build the internal audit function across the Government, including GBEs and local government.

External audit is benefitting from technical assistance recently but remains in need of major work to lift its capability and reliability.

Work is proceeding to improve the procurements system's processes, regulations and controls. A sustained effort is needed in building a credible and effective procurement system.

The ADB is supporting work to sort out quite serious issues about Government Business Enterprise (GBE) governance and financial performance. This should lead to sustained information on contingent liabilities.

Overall there is a credible program of individual improvements under way. However there are gaps and the improvements will take years to develop the professional skills, supporting systems and values that would justify complete reliance by donors on the decentralised systems of procurement and financial control – without imposing additional requirements. A strong and sustained capacity building program in financial management in line ministries and service delivery units is required, whereas the current situation seems rather ad hoc.

Local government finance also needs a comprehensive program of reform aimed at finding the best allocations of functions and finance.

The ANS recommends that donors should extend the use of upstream systems as fast as practicable - in the light of the fiduciary risks identified and progress with measures to reduce those risks. E.g. strengthening Parliamentary oversight of the GoV finances.

With regard to the downstream systems, those parts that are the responsibility of the MFEM are developing quite well. There is the capability, with some occasional assistance under the Governance for Growth Program, to revise and upgrade regulations, laws and procedures. But fiduciary risks stem from low capacity, misappropriation and mismanagement by ministers, in ministries and service delivery units.

Accordingly the ANS recommends that donors consider not using downstream PGS at this time without additional risk mitigation measures in place. These measures are not just additional checks, procedures and information requests but time consuming programs of capacity building for financial management in line ministries and service delivery units. Each donor will judge the situation in relation to its tolerance for fiduciary risk. AusAID should not rely on downstream systems without mitigating measures at this time.

The ANS review sets in place the challenge of lifting financial management capability and probity. The areas of moderate and high fiduciary and corruption risk to the use of PGS that are identified in the ANS are:

- Medium term integrated budgeting, planning and financing, which will take years to achieve
- GBE governance, accountability and performance
- Line ministry PFM improvement which extends fully to service delivery units
- Contingent liabilities arising from local government financial transactions
- Revenue administration
- Procurement
- Internal audit
- External audit
- Local government finances and functions

The ANS provides the detail and supporting arguments for initiatives to make progress in these areas, which need not be repeated here. This should be the foundation of the next agenda of improvements to the financial management system. The proposed interventions are described there in various levels of detail. The GfG should equip itself to assist the GoV in making these improvements. GfG will recruit a ‘downstream’ Public Financial Management Adviser specifically to assist in this area (see draft Terms of Reference at Annex 6). This will be a major contribution to the maturing of the partnership dialogue and the associated programs.

Improving information on service delivery

The list of issues noted above, and that require attention for reform of financial management and accountability, should also have a strong performance orientation as measured by the cost-effectiveness of service delivery. This will require the details of the budget and financial systems to be designed in ways that promote performance. How this is best done specifically in each area of service delivery should be dictated by the nature of the service, the current status of the associated financial system, realistic plans for its improvement and practical possibilities for linking financial information with other performance information.

While the backbone of the financial system must extend through the system from high level budget appropriations down to expenditures by local schools etc., the associated performance management systems should be pragmatic and derived from sector knowledge of performance problems in achieving sector strategies, or just simple performance needs e.g. getting teachers and books into classrooms. An over-arching methodology of performance budgeting (e.g. Program Performance Budgeting of some kind) is not appropriate at this stage and should not be considered for a long time. But easily available information on whether items procured do arrive at their intended destination e.g. drugs in hospitals, should be collected and reported routinely and does not require great technical expertise. Such information promotes transparency and also facilitates problem diagnosis and periodic program evaluation.

MFEM, assisted by GfG, should work with the line ministries to develop and upgrade their financial systems and basic requirements for performance information. The latter should be systematised in practical low cost ways, routinely monitored by the ministries, available to the MFEM budget analysts and required to accompany budget submission to support estimates of the costs of service delivery.

In many areas donor programs will already have required performance information to be used and various measures of the costs of service by volume will be available. It will useful to bring such of this as is useful for developing the skills of budget analysts in both MFEM and line ministries into the routine budget and performance management systems in the sectors. This can help give the investments in analysis that are done in support of donor activities in the sectors some continuity and sustainability in the emerging public management system.

Institutional reform for improved service performance

Budgeting and public management is generally very centralised and there is scope for achieving service and efficiency improvements by working on the accountability interfaces between the centre of government and the service delivery units – schools, hospitals. There is also scope for achieving greater effectiveness through partnering with the community organisations. Within the context of the sector programs these interfaces for funding and performance monitoring should be prioritised and reviewed to find improvements that can be made. In most cases holding service units to account for performance in practical ways has to go in parallel with the development of their management systems.

The GfG expert on public finance and management should work on these interfaces as part of the work program of linking the central management systems better to the ministries and service units.

Alternative methods of financing infrastructure

Some of the major infrastructure investments being contemplated will be privately run and largely privately financed. These methods of finance can be attractive in concept but their track record is very mixed. Often they are used to put investment below the line in the government books and make the fiscal policy look better. But this can conceal an implicit cost of borrowing in the charges paid by taxpayers or users that is higher than the government's alternative borrowing cost. Also it is common for private parties to require government guarantees that raise contingent liabilities that are not recorded in the government's accounts. In spite of these risks, public-private partnerships can bring real benefits in terms of technology, management skill and strong incentives to meet service criteria that would not otherwise be available. These arrangements are complicated both technically and in negotiation and prone to corruption. The GfG should be ready to engage with the authorities and donors if these alternative methods of infrastructure development are to be pursued.

Assessing distortions in the aid flow

How are the development partners to have reasonable assurances that the flow of donor assistance is supporting the GoV's development objectives and not distorting their achievement? Such assurances can come from several sources:

- The choice of development objectives by the GOV should emerge within policy dialogue that is based on sound principles and practices described elsewhere in this report. These include creating and sustaining the balance of negotiating capital.
- The GOV decisions about what developmental activities are undertaken and the assistance to support these should be taken within frameworks of good governance (sound and stable budget processes and decision making, effective management of projects and continuous process for service delivery, stakeholder engagement, transparency and low levels of corruption).
- These decisions should also be based in sound evidence based analysis and political savvy and
- They should be competently implemented.

With these conditions in evidence the aid flow can be expected to promote and support well thought out and articulated development priorities that are consistent and sustainable. The activities chosen would have high impacts on these priorities. There would be support for strengthening the systems for implementation and accountability.

But by the same token, weaknesses in dialogue, governance, analysis and implementation of policies raise risks that the flow of assistance may distort development away from chosen and sensible paths. Some indicators as to whether such weaknesses are in evidence would be:

- Evidence of distortion of fiscal choices (e.g. lack of integration of capital and recurrent expenditure planning and management)
- Distortion of factor proportions (ratios of labour, capital, natural resources in production and choices of technology) leading for example to capital intensive projects that do not create local jobs
- Macro-economic instability that is caused or amplified by the flows of foreign assistance (volatile pressures on exchange rates, interest rates, inflation, employment and the balance of payments)

How does the flow of Australian assistance to Vanuatu appear with these issues in mind?

There is near total reliance on domestic revenues for current expenditure, whereas capital expenditures are, by and large, donor funded. Forty per cent of current expenditure is wages and the authorities, with the IMF backing, are currently suppressing wage growth for fiscal reasons. The wage rates are low however and so this expenditure is going to increase its share at some point.

Over time AusAID's Vanuatu program has been increasing its emphasis on supporting the recurrent costs faced by Government. In fact, a number of major elements of the program already cover recurrent costs of capital investment. Some examples are:

- VTSSP Phase 2 will move to a primarily maintenance-focussed program with around 75% of the first-year budget going to maintenance. Addition of new road upgrading will be contingent on funds remaining from the maintenance work. This is aimed to incentivise more efficient road maintenance and only add additional roads if there is maintenance budget to cover them.
- The Utilities and Telecoms regulators where AusAID provides supplementary funding through the World Bank for some staff and operating expenditure such as legal costs.
- School Grant program where AusAID has funded the phase in of on-budget school grants for maintenance and recurrent costs and to offset school fees
- AusAID funds the procurement of health and education supplies and some staff (such as surgeons).

Road maintenance in Tafea Province

232 km of road – most are not maintainable as they are just tracks.

30 km developed under VTSSP is maintainable.

Maintenance at minimum level requires cutting grass that creeps onto the carriageway, clearing gutters and culverts. It should be done 3-4 times a year.

Each time this maintenance is done it costs around 400 person days per km, so the annual cost is about VT 2 million, or A$20,000 per km per year for minimum maintenance.

This is VT 60 million for 30 km.

The entire budget for road maintenance in the national budget is VT 500 million.

An estimate of the bill for maintenance of the roads nation-wide is VT 10 billion.

Total recurrent revenue in the 2011 budget is VT 13 billion.

The VTSSP project (with its list of 56 priority infrastructure investments) will stimulate interest in infrastructure investment, making it all the more important to get all parties considering the medium to long term implications of their investment decisions. The downstream burden of maintaining donor funded assets will likely overwhelm the recurrent budget unless a multi-year budget framework is developed that integrates recurrent and capital expenditure.

Capital assets financed by aid were chosen in part for their impact on private sector development – although one might wonder about roads that have tiny volumes of traffic – and the expectation that they would stimulate business activity and domestic tax revenues. But the prospect that these assets will degrade quickly through not being maintained is a real possibility. The alternative is to effectively earmark future budgets indefinitely for maintenance with risk that revenues do not grow fast enough to cover the costs.

From a broader perspective the question arises as to whether the factor proportions of the development program are being distorted by the institutional arrangements around the aid flow. It seems so. So it would seem sensible for the policy dialogue to address this issue directly and find new institutional arrangements that avoid the risk of this distortion. Without this the assets are likely to be run down and/or the donors will be faced with maintaining them to avoid writing down their previous investments.

Revenue policies

The need for continuing attention to revenue policies and revenue administration is obvious and GfG should engage in any major opportunities to support this where it has comparative advantage. This should include not only taxes of various kinds but also establishing a sound framework for setting government charges. However revenue policies and administration are very specialised areas and GfG would be advised not to get into them without having the necessary expertise attached to it.

Personnel policies and practices

The personnel policies and functions of the government need a rapid upgrade. The goals should be to reduce the political control of the civil service over time as far as politically practicable and to promote merit-based appointments. The performance requirements of the ministries should be linked to sector strategies, good governance agendas and effectiveness and efficiency of resource use. The opportunity for an improvement in personnel policies and administration does not appear at present but if it does then GfG could assist the Government in this endeavour.

Proposal for GfG role in further public sector and financial management reform

The GfG will recruit a senior specialist in budgeting and public finance with a good knowledge and experience of wider issues in public management reform. This person should start work from the recommendations in the ANS report and work with MFEM to set up work streams to attend to the main issues in need of attention:

- Procurement;
- Internal audit;
- Linking central financial management systems better with line ministry systems and lifting the integrity and effectiveness of line ministry systems;
- Develop simple approaches to collecting non-financial performance information that can be reported together with budget and accounting data in the budget process and that is of value to the line ministries and service delivery units;
- Medium term fiscal planning;
- GBE financial controls and transparency;
- Local government finance.

The decisions to initiate particular pieces of work within this agenda will be dependent on the decisions of the GfG leadership in accordance with its general criteria as to when to enter and when to exit a work stream.

The outcomes that should be expected from this whole area of work are:

- A measurable lift in the performance characteristics of the financial management system in accordance with standard indicators used diagnostic instruments internationally and prioritised to focus on the areas noted above.
- Some practical performance information about resource use and service delivery in the main areas of public expenditure.
- A practical and useful medium term fiscal framework that links to macroeconomic policy and decisions about the balance of sectoral expenditure and integrates planning of capital and recurrent expenditure around major areas of capital expenditure.

The Terms of Reference for this adviser are set out in Annex 6 with proposed activities to be undertaken.

Annex 4: Budget and Cost Estimates

(Australian dollars)

AUD Australian dollars	2012/13	2013/14	2014/15	2015/16	Total
Program Management					
Core Staff, operational costs, advisers	700,000	1,000,000	1,000,000	1,000,000	**3,700,000**
Program Design				200,000	**200,000**
Performance/Evaluation	50,000	50,000	75,000	50,000	**225,000**
Managed Funds					
Prime Minister's Office	750,000	750,000	750,000	750,000	**3,000,000**
Ministry of Finance & Economic Management		750,000	750,000	750,000	**2,250,000**
Energy Sector	1,000,000				**1,000,000**
Aviation Sector	500,000				**500,000**
Telecommunication Sector	1,500,000	500,000	500,000	230,000	**2,730,000**
Knowledge, Analysis, Research, Briefing	300,000	250,000	250,000	250,000	**1,050,000**
Unallocated (Flexible Fund)	1,200,000	2,500,000	2,500,000	2,500,000	**8,700,000**
Total	**AUD 6,000,000**	**AUD 5,800,000**	**AUD 5,825,000**	**AUD 5,730,000**	**AUD 23,355,000**

Notes:

- The budget and cost estimates have been provided by GfG on the basis of current actual and forecast program costs, adjusted slightly by the design team where extra emphasis was required (Knowledge, Analysis, Research, Briefing).
- Although GfG will divest its responsibility for infrastructure, the budget provision for the *Infrastructure Adviser* remains under the GfG's allocation for the time being for internal AusAID budgeting purposes.
- At this stage a budget is presented for four years only, on the assumption that there will be a design undertaken in 2015/16 for further support beyond that.

Annex 5: Draft Terms of Reference for the specialist in macroeconomic policy and development policy

Background

The Governance for Growth program (GfG) was established in 2006/07, within the mandate of Vanuatu's 2006 Priorities and Action Agenda, to help generate economic growth and improve service delivery through good governance. It is now entering its second phase (2012-2016).

Critical to GfG's design is a recognition of the need for a deeper partnership between donor and government, able to go beyond sectoral and technical fixes, to address more fundamental policy and institutional issues that shape the pace and quality of economic growth and poverty reduction. GfG was thus established as an adviser, facilitator and broker of regulatory reform and improved public expenditure management, for the purposes of improving growth and service delivery. It was constructed as a platform for effective policy dialogue, supporting the analytical and consultative processes that inform policy formulation, as well as providing resources for policy implementation.

The mid-term review of GfG first phase showed that it is widely regarded as having been successful in achieving the goals set for it as an innovation in the way AusAID relates to the GoV and supports the Australia-Vanuatu Partnership for Development. The essential features of GfG design have been to take a cross-sectoral view of the partnership, have close relationships with GoV authorities, be flexible and take opportunities as they arise to assist GoV with activities that fit generally within a mandate of governance, economic policy and financial management. The principal counterparties have been the Prime Minister's Office (PMO) and the Ministry of Finance and Economic Management (MFEM).

Following the mid-term review, GfG's design is being adjusted to reflect what has been learned and also changes in its agenda to reflect emerging priorities. During the first five years of GfG, the Government of Vanuatu has made steady and significant advances in the conception and development of its economic development strategy and produced a *Priorities and Action Agenda 2006-2015*. This sets out its development priorities under seven headings that cover economic management, governance, productive sector development and service delivery. GoV has also set a more immediate agenda of work on particular issues – '*Planning Long Acting Short*'.

The current situation however shows a need for greater integration of development planning, financing and implementation and new priorities for macroeconomic and economic development strategy. Attending to this situation requires expertise in macroeconomics and longer term development planning to provide a deeper level of analysis of how fiscal and monetary variables and policies interact both in terms of short-term stabilisation and longer-term development. There are concerns that the donor presence is so large as to be a major driver of the economy in aggregate and in relation to the balance of the private and public sectors, movement in the real exchange rate and the balance of recurrent and capital expenditure. These aggregate relationships may also be important to explaining the balance of rural and urban development and the distribution of national income.

An expert who can span these issues is needed to deepen the theoretical and practical understanding of macroeconomic developments and their integration with major developmental strategies concerning growth and distribution. This includes the balance of rural and urban economic development.

Expected outcomes

The adviser will contribute demonstrably to lifting the sophistication and wider understanding of how macroeconomic policy, development policy and public finance come together to promote the opportunities for Vanuatu to raise its overall standards of living.

As a consequence of the activities of the adviser and the GfG working with the PMO, MFEM, Reserve Bank of Vanuatu, donors and representatives of the private sector and civil society, there will be a wider appreciation of the way the economy works, the trade-offs that decision-makers face in the quest for higher living standards and risks that must be managed.

The PMO and MFEM will lift their capability for macroeconomic analysis and development policy for a mixed market economy and reflect this in its work in fiscal strategy, budget analysis, budget implementation and aid coordination.

Activities

- Provide methods and staff training to provide the macroeconomic framework for a medium term fiscal strategy including forecasting models and risk analysis
- Work with the PFM specialist to analyses the macro and micro economic distortions that are flowing from the dependence of recurrent expenditure on local revenues and of capital expenditure on donor support.
- Analyse and communicate with key policy makers and financiers about the efficiency and stability of the financial markets and the impact of donor and GoV financial flows on the nominal and real economies and hence on the real exchange rate.
- Work with the authorities to add sophisticated macro- and micro-economic analysis to the development planning and budgetary processes.
- Analysing distributional impacts of economic trends and development policies.

Counterparts

- MFEM, PMO and Reserve Bank of Vanuatu
- Development economists with relevant interests
- Private sector leaders and financiers with interests in Vanuatu
- Civil society groups with an interest in economic development

Reporting relationships

- Reports equally to the Director of GfG and the GfG Director's counterpart(s) (depending on the issue) in the Government of Vanuatu

Reports

- By agreement with Director of GfG on progress with the activities above and the needs of GoV and AusAID for management information and accountability

Competencies

- Substantial experience at a senior level within government on the provision of policy advice across a broad spectrum of economic policy
- Ability to work with data in a developing country environment and draw judgements
- Ability to communicate complex economic relationships to decision makers and lay audiences

- Easy familiarity with working in developing countries and communicating well across cultural differences.
- Passion for this kind of work in a challenging environment

Duration and timing

- To be decided – probably 3 years with possible renewal.

Annex 6: Draft Terms of Reference for the specialist in financial management and public sector management reform

Background

The Governance for Growth program (GfG) was established in 2006/07, within the mandate of Vanuatu's 2006 Priorities and Action Agenda, to help generate economic growth and improve service delivery through good governance. It is now entering its second phase (2012-2016).

Critical to GfG's design is a recognition of the need for a deeper partnership between donor and government, able to go beyond sectoral and technical fixes, to address more fundamental policy and institutional issues that shape the pace and quality of economic growth and poverty reduction. GfG was thus established as an adviser, facilitator and broker of regulatory reform and improved public expenditure management, for the purposes of improving growth and service delivery. It was constructed as a platform for effective policy dialogue, supporting the analytical and consultative processes that inform policy formulation, as well as providing resources for policy implementation.

The mid-term review of GfG Phase I showed that it is widely regarded as having been successful in achieving the goals set for it as an innovation in the way AusAID relates to the GoV and supports the Australia-Vanuatu Partnership for Development 2008. The essential features of the GfG design have been to take a cross-sectoral view of the partnership, have close relationships with the GoV authorities, be flexible and take opportunities as they arise to assist the GoV with activities that fit generally within a mandate of governance, economic policy and financial management. The main counterparty has been the Ministry of Finance and Economic Management (MFEM) and the GfG has also been assistance to the Prime Minister's advisers on various issues.

Following the mid-term review, the GfG design is being adjusted to reflect what has been learned and also changes in its agenda to reflect emerging priorities. During the first 5 years of the GfG the GoV has made steady and significant advances in the development of its conception of its economic development strategy and has produced a strategy called Priorities and Action Agenda 2006-2015. This sets its development priorities under seven headings that cover economic management, governance, productive sector development and service delivery. The GoV has also set a more immediate agenda of work on particular issues known as Planning Long Acting Short.

The current situation however shows a need for greater integration of development planning, financing and implementation and new priorities for building capability in macroeconomic policy, economic development strategy and improved service delivery..

A central priority for the GfG has been assisting the GoV to design and implement an improved system of budgeting and financial accountability and reporting. A comprehensive review has been recently completed of the whole system of budgeting, financial reporting and accountability. This review is known as the Assessment of National Systems (ANS) and its focus is on what upgrades are needed to justify much greater use of Vanuatu Government systems by donors. Key conclusions were that there are serious issues in procurement, audit and a need for much better linkages between the central budget and the line ministries and service delivery units. Over a period of years a multi-year fiscal planning framework is required to support macroeconomic stabilisation policy, development strategy and improved budget decision making.

Expected outcomes

The adviser will contribute demonstrably to creating with the authorities a new agenda in financial management reform and better service delivery based on the ANS recommendations.

As a consequence of the work of the adviser there will be a measurable lift in the performance characteristics of the financial management system in accordance with standard indicators used diagnostic instruments internationally.

Working with the MFEM, the sector ministries and their donor counterparts the adviser will assist in the development of practical performance goals for providing resources to priority areas of policy development and service delivery. Simple systems will be in evidence for collecting and monitoring performance information and associating this with budget submissions and expenditure analyses.

The medium term fiscal framework will be designed and trialled, then rolled out across the ministries.

Procurement policy and practices will improve although the adviser can expect specialist expertise on procurement to be provided.

GfG through the adviser will make a contribution to supporting the MFEM's program for building an internal audit system.

If local government finance and PPP methods of financing infrastructure investment get onto the GoV agenda then the adviser would contribute to integrating these into the financial management system in accordance with modern accounting conventions and full transparency in reporting.

In association with specialist expertise in business analysis and corporate governance the adviser would bring the financial performance of the Government Business Enterprises fully into comprehensive reporting on the GoV financial position.

By the end of the period of engagement there will markedly greater use of GoV systems by AusAID and other donors as reflected in the removal of most of the constraints to this that are identified in the ANS report.

Activities

- Work with MFEM to design and implement an agenda of work arising from the ANS report.
- Provide methods and staff training to assist MFEM in implementing specific aspects of financial management improvement.
- Work with line ministries and their finance officers and others to build strong linkages between the central and line ministry financial system.
- Work with the macroeconomic adviser to integrate macroeconomic and fiscal forecasting into a medium term fiscal strategy including forecasting models and risk analysis.
- Work with AusAID and other donors to analyse and address fiscal distortions that are flowing from the dependence of recurrent expenditure on local revenues and of capital expenditure on donor support. Design a system for integrating consideration and reporting of recurrent and capital expenditure in the medium term fiscal framework and in budgeting.
- Work with MFEM and donors to develop communications materials about budgeting and reporting.

Counterparts

- MFEM, line ministries AusAID and other donors
- Finance officials in line ministries, service units, GBEs and local government
- Private sector leaders and financiers with interests in Vanuatu
- Civil society groups with an interest in transparent fiscal policy and public accounting

Reporting relationships

- Reports equally to the Director of GfG and the GfG Director's counterpart(s) (depending on the issue) in the Government of Vanuatu

Reports

- By agreement with Director of GfG on progress with the activities above and the needs of the GoV and AusAID for management information and accountability

Competencies

- Substantial experience at a senior level within government on budgeting and accounting
- Ability to communicate well with finance officials across the Government and to promote better financial management to decision makers and lay audiences
- Easy familiarity with working in developing countries and communicating well across cultural differences.
- Passion for this kind of work in a challenging environment

Duration and timing

- To be decided – probably 3 years with possible renewal.

Annex 7: Draft Terms of Reference for the monitoring & evaluation / performance & effectiveness specialist (Periodic / part-time input)

Background

The Governance for Growth program (GfG) was established in 2006/07, within the mandate of Vanuatu's 2006 Priorities and Action Agenda, to help generate economic growth and improve service delivery through good governance. It is now entering its second phase (2012-2016).

Critical to GfG's design is a recognition of the need for a deeper partnership between donor and government, able to go beyond sectoral and technical fixes, to address more fundamental policy and institutional issues that shape the pace and quality of economic growth and poverty reduction. GfG was thus established as an adviser, facilitator and broker of regulatory reform and improved public expenditure management, for the purposes of improving growth and service delivery. It was constructed as a platform for effective policy dialogue, supporting the analytical and consultative processes that inform policy formulation, as well as providing resources for policy implementation.

GfG is widely regarded as having been important and influential in its first phase, and highly valued. While a number of reviews and studies have demonstrated significant impact, Phase I did not set out a clear program logic, and its performance frameworks were pitched at a level that was difficult, in practice, to report against objectively and empirically.

For Phase II a more robust program logic and M&E plan has been mapped out (pages 22 to 25 of the Program Design Document), with broad measures of performance suggested at each of three levels:

I. The quality of GfG activity, particularly in terms of the scope, quality and results of its **policy dialogue**.

II. The extent to which 'governance' is strengthened, through GoV-GfG support, in terms of **capabilities, accountabilities and responsiveness** of target institutions.

III. The coherence, credibility, effectiveness and value-for-money of the contribution GfG makes, or can later be evaluated as having made, towards bringing about institutional ('rules of the game') reforms that result in **faster, more equitable, growth and better quality, more accessible, services**. (As measured in terms of economic and sector performance **results**.)

Expected outcomes

GfG is producing succinct, credible, outcome-orientated and evidence-based data on, and analysis of, performance at all three levels above, that inform decision-making and which account for the performance[30] of this part of the aid program.

GfG is also able to account for its contribution to the achievement of relevant 'Tier 2' results under AusAID's Comprehensive Aid Policy Framework.

Activities

Working principally as a facilitator and mentor to GfG Program Managers and key GoV staff:

[30] The DAC criteria of relevance, effectiveness, efficiency, impact and sustainability, as well as additional AusAID criteria of monitoring and evaluation, gender equality and analysis and learning.

- Through stakeholder engagement, the development of 'what success looks like' at each level, and for each significant GfG intervention. (Including establishment of 'what's currently wrong' / baselines.)
- The development of simple but meaningful performance assessment frameworks (including approaches to monitoring and evaluation) for GfG as a whole and for each significant GfG intervention.
- The development of protocols and capacity to conduct meaningful performance and quality data and information from the GfG program.

Reporting relationships

- Reports equally to the Director of GfG and the GfG Director's counterpart(s) in the Government of Vanuatu

Reports

- By agreement with Director of GfG on progress with the activities above and the needs of the GoV and AusAID for management information and accountability

Competencies

- Substantial experience in the conceptualisation, management and reporting of the performance of development interventions, applicable to governance, policy and public expenditure reform
- Ability to communicate well with officials across government, GfG and its other development partners to promote better understanding of the outcomes and impacts of development interventions
- Familiarity with AusAID's performance and quality agenda
- Easy familiarity with working in developing countries and communicating across cultural differences.
- Passion for this kind of work in a challenging environment

Duration and timing

To be decided – probably 3 weeks initially followed by regular short-term inputs over four years

Annex 8: Highlights from AusAID's recent *Assessment of National Systems* in Vanuatu (in draft)

Summary

This Assessment of National Systems (ANS) is intended to inform AusAID's decision whether to use partner government systems in Vanuatu. In addition to providing an overall balanced assessment of the GoV (Government of Vanuatu) national systems this assessment identifies specific problem areas where fiduciary risks are high or where much expanded use of Partner Government Systems (PGS) may pose significant or unacceptable fiduciary or corruption risks. Around one third of budgeted expenditure is financed by assistance and hence it is essential that there is support for lifting the capacity and integrity of the PGS.

Because of its role as dominant donor, other donors that fund large projects and programs almost invariably look to Australia for support and partnership in some form. The degree of consensus among donors on the use of PGS is significant for orderly support for the improvement in and use of these systems over time.

The overall picture of fiduciary risk from the use of PGS as reflected in the international standard diagnostics is that is that they are mostly low with respect to the 'upstream' elements of the financial and budgeting system, for two reasons. The Ministry of Finance and Economic Management (MFEM) has done well in building capability and managing its role in those areas where it has strong influence because it is fully responsible for those systems. Further, these upstream systems are about presentation of budget and financial information, whereas the fiduciary risks of PGS are mostly downstream in areas of budget execution, controls and audit within a framework of decentralised management. Specific comments on risks in the upstream systems are as follows. However within this picture there are particular risks.

The upstream systems are well short of best practices in medium term expenditure planning and management – although the system operates efficiently through the annual cycle. From a donor perspective this means that multi-year projects and projects that cross fiscal year boundaries are not captured in the upstream systems in ways that promote clarity and better decision on a multi-year basis. In particular the ongoing maintenance expenditures from donor supported infrastructure projects are not properly allowed for.

The classification systems and conventions for the budget and accounting systems are acceptable but inevitably the routine generic information they produce will be insufficient for donor accountability and management purposes in specific areas. This will involve greater detail in reporting in many cases but also specific requirements for additional information depending on the sectors and projects in question. This is pretty much a continuation of the situation today.

The lack of coverage of off-budget entities and contingent liabilities from Government Business Enterprises (GBEs) and local government is rated as a high risk, although the impact on donor fiduciary interests is largely through the aggregate fiscal risk these create and not a direct risk to donor projects except where these off budget entities are involved.

Poor legislative scrutiny of budgets, accounts and audit reports is a high fiduciary risk for donors – especially in light of the weakness in the audit function. Essentially the Parliament is doing poorly in holding the executive to account for the use of GoV and donor monies.

With regards to the downstream systems the weaknesses are more serious and present greater risks to donors.

Tax administration needs to be greatly improved. From the donor perspective the lack of a robust and growing domestic revenue flow must be a concern, especially regarding the funding of the maintenance of donor funded infrastructure.

The greatest weaknesses and associated fiduciary risks are consequent in large measure on the decentralised system of financial management. These risks appear upstream where non-compliance and errors with information requests can compromise budgets and accounting reports. And they appear downstream especially in the procurement system and in the lack of internal audit and assurance functions in line ministries and service delivery units. Internal controls on non-salary expenditure in ministries are also an area of weakness.

The major weaknesses and risks are in procurement where the diagnostics and supporting information show that the system is not operating to a standard where donors should use it without taking very high levels of risk and/or continuing to require additional steps in the processes, and controls to manage those risks.

The lack of internal audit and assurance processes across the ministries is a second major area of weakness and risk. Without these the regulations that are by and large acceptable – with some exceptions – are not being complied with, or there is no assurance of such.

External audit is benefitting from technical assistance recently but remains in need of major work to lift its capability and reliability.

The 2008 financial management reform plan had eight objectives and progress has been made on these. Notably the financial management information system (FMIS) has been made available on line to ministries to support and discipline their financial management. Also Financial Service Bureaus (FSB) are being installed around the country to enable decentralised access to systems and information.

Work is proceeding to improve the procurement system's processes, regulations and controls.

The MFEM is launching a substantial initiative in internal audit, which is to run across the ministries.

The ADB is supporting work to sort out the GBE governance and financial performance. This should lead to sustained information on contingent liabilities.

Overall there is a credible program of individual improvements under way. However there are gaps and the improvements will take years to develop the professional skills, supporting systems and values that would justify complete reliance by donors on the decentralised systems of procurement and financial control – without imposing additional requirements. A strong and sustained capacity building program in financial management in lien ministries and service delivery units is required, whereas the current situation seems rather ad hoc. Local government finance also needs a comprehensive program of reform aimed at finding the best allocations of functions and finance.

A similarly sustained effort is needed in building a credible and effective procurement system.

Strong support should be given to the MFEM's endeavours to build the internal audit function across the Government, including GBEs and local government.

It is recommended that donors should extend the use of upstream systems with the qualifications outlined and at a pace which is as fast as practicable - in the light of the fiduciary risks identified and progress with measures to reduce those risks. E.g. strengthening Parliamentary oversight of the GoV finances.

It is also recommended that in respect of upstream systems donors promote and support improvements in these and in particular, over several years, the development of a multi-year fiscal planning framework that integrates current and capital expenditures and allows for donor support for current as well as capital expenditures.

With regard to the downstream systems, those parts that are the responsibility of the MFEM are developing quite well and there is the capability, with some occasional assistance under the Governance for Growth Program, to revise and upgrade regulations, laws and procedures continually. But the fiduciary risks are stemming from low capacity and corruption by ministers, in ministries and service delivery units.

It is recommended that donors not use downstream PGS at this time without additional risk mitigation measures in place. These measures are not just additional checks, procedures and information requests but time consuming programs of capacity building for financial management in line ministries and service delivery units. Each donor will judge the situation in relation to its tolerance for fiduciary risk. AusAID should not rely on downstream systems without mitigating measures at this time. Aside from the general capacity building programs being recommended such measures are likely to be specific to the sectors and the nature of the donor support.

Concluding Judgment on Use of Country Systems

AusAID's planned expenditure for 2011-2012 is A$53million or VT4.8 billion which compares with the 2011 budget forecast for 2012 of VT21 billion, or approximately 23 per cent. Other donors are proposing another VT2.2 billion according to the 2011 budget forecast so that a total of 33 per cent of budgeted spending is financed by assistance grants. The narrow tax base of Vanuatu is producing a budgeted VT14 billion and cannot support heavy spending on vital sectors like Health and Education while also providing for the maintenance of rapidly expanding public infrastructure. At this level of spending by donors the need for PGS that can securely and effectively manage this flow of funds is obvious and urgent. The key issue is how to support the development of the required capacity for wider use of PGS as fast as is reasonably achievable.

The areas of moderate and high fiduciary and corruption risk to the use of PGS that are identified in this report and noted above are:

- Medium term integrated budgeting, planning and financing, which will take years to achieve
- GBE governance, accountability and performance
- Line ministry PFM improvement which extends fully to service delivery units
- Contingent liabilities arising from local government financial transactions
- Revenue administration
- Procurement
- Internal audit
- External audit
- Local government finances and functions

Use of Upstream Partner Government Systems

It is recommended that donor support should be aligned with some upstream elements of PGS in Vanuatu. That is, donor support can satisfactorily be provided 'On plan', 'On Budget' and 'On Parliament'. But there are important details as to how this is done and under what conditions.

Being on plan means only that AusAID funds are reflected in GoV strategic plans. Those plans are not at this time very suitable for integrating with a fiscal planning framework. Donor support should aim over a period of years to go on plan in a deeper sense of donor funds being included in a medium term fiscal planning framework with measures to track expenditures against plan through ministries and service delivery units. With this objective in mind, donor discussions with GOV should point to the need for a deeper fiscal planning process and method.

Being on budget means at this point being included in the budget documents. This is a start, but actions to strengthen the budget's incorporation of donor funds should progressively move to an integrated budget process that allows for interactions between budgeting for the GoV funds and the donor funds. Specifically, the budget should provide for integration of capital and maintenance budgets to ensure that donor funded infrastructure is properly maintained. When the planning and fiscal processes are better merged it will enable more detailed consideration of the allocation of funds from whatever sources to detailed items of expenditure linked to development program goals.

Parliamentary oversight of budgeting, accounting and audit is too weak for donors to rely on as a source fiduciary assurance. The means by which Parliament holds the Executive to account should be strengthened. This could be done by supporting the Public Accounts Committee at least to scrutinise the budget and to review reports by the Auditor General. At some future time the position of donor funds in relation the appropriation acts should indicate a move towards greater Parliamentary oversight of the donor funds. So being 'on Parliament' will in the meantime need to be accepted by donors as a formality that points in the right direction, but not a substantive fiduciary control to begin with.

Contingent and non-transparent liabilities arising from the financial affairs of the GBEs and sub-national governments need to be vigorously addressed in the ADB study. Such liabilities can materialise at short notice and destroy fiscal and development objectives by presenting urgent demands for bail-outs.

Use of Downstream Partner Government Systems

It is recommended that AusAID (and other development partners) should work with the GoV with the objective of further aligning its support with the following three downstream elements of PGS:

- Disbursement through GoV Treasury ('On Treasury');
- Accounted for through the GoV accounting system ('On Accounting');
- External financing be included in GoV's reports ('On Report').

'On Treasury'

AusAID guidance for this is "External financing is channelled into the main revenue funds (or accounts) of government and then managed through the government's regular systems of disbursement and financial control."

The current situation is that AusAID funds are paid into the government's Development Fund, which sits with the Reserve Bank. Those funds are then drawn upon by GoV for a range of purposes. The funds are not separately quarantined. I.e. the Development Fund is not a trust account with funds earmarked for a certain purpose, until the money is drawn down for that purpose. It is as if the GoV owes AusAID a promissory note, or credit, to spend $X amount for $X purpose. The accounting system (Smartstream) codes and reports that expenditure. So AusAID already relies on GoV accounting and reporting. But AusAID is able to (and does) request detailed spending against its project codes as regularly as it wants. AusAID also commissions audits of expenditure against what is being reported/claimed. This practice should continue but with a commitment to move to a more integrated budget system as described above.

The picture overall is that the treasury controls over expenditure are reasonably good and are already being used by AusAID. The fiduciary risk is in the line ministries – a point that is emphasised in several parts of this report. Attention to lifting FM capacity and performance in line ministries is therefore important as is emphasised in the section on PFM system risks.

Being on treasury also implies satisfactory performance in cash and debt management, although this is not emphasised in the AusAID relevant guideline. It is explained above that the management of funds and recording of debt is good enough to be acceptable for donor purposes. There are problems with guarantees and other contingent liabilities especially for local government and GBEs. However, as explained above, the contingent liabilities from GBEs may not be as big a problem as it might appear. The greater worry is in local government. So further deepening of the reliance on treasury should be accompanied by the Treasury taking responsibility of managing these contingent liabilities.

'On Accounting' and 'On Report'

Overall, the accounting and reporting systems are performing well enough to justify their use in relation to donor funds. However the AusAID requirements for being fully on accounting and reporting are more strict than is justified by the status quo and so extra requirements should be negotiated. Specifically, the classification system used by the GoV may not provide all the information that AusAID needs for reporting to Canberra. Some extra information or transformations of the data in the accounting system may be required. Also, it is unlikely at this time that the financial reports of the GoV will be all that AusAID requires and whatever extra reports that are needed should be negotiated.

Information on resources received and used by service delivery units is likely to inadequate for AusAID's needs. Budgeting and accounting systems really only operate effectively at central government and ministry level. There is a lot of work to be done in improving management at the operational level and focussing more on the use made of resources to achieve performance targets. As discussed above, ministries have quite a lot of flexibility to re-allocate resources within the ministry. This should be monitored.

This illustrates the consistent pattern through this ANS – that the MFEM is conducting its operations to a level that should generally satisfy donors, but the risks lie in the ministries and service delivery units. As is stated elsewhere "Major weakness is seen in failure by line ministries to discharge their responsibilities for oversight of use of public resources."

In common with many countries at a similar level of public sector capability the ministry of finance has made good progress on its responsibilities, but it will take time and a considerable effort in capability building to get the ministries first, and then the service delivery units, up to desirable levels within an integrated government wide FMIS.

Guideline 220 states "When AusAID funds are to use downstream components of PGS, the grant agreement with the partner government needs to be carefully drafted in parallel with the implementation arrangement (or design document). It needs to detail the long and short-term risk mitigation measures agreed with the partner government (as per Section 4.1) and specify any conditions for disbursing tranches of AusAID funds to the partner government. Additionally, the grant agreement needs to clarify any sanctions that could be imposed by AusAID for serious violations by the partner government of the terms and conditions in the instrument. Advice on drafting the grant agreement and details of templates can be obtained from WIPS."

In conformity with this requirement, it is recommended that the existing arrangements for donor funds to be on downstream systems be extended, subject to specific measures in the grant agreements and design document to address the weaknesses identified in this report. This applies especially in the areas of lifting PFM capability in line ministries and service delivery units. In addition to general support for the initiatives detailed in the section above on reform initiatives, which as noted there address many of the weaknesses identified in this report there should be specific measures taken to mitigate weaknesses in areas where significant donor funds flow through the PGS. What these need to be in each case depends on the program that AusAID seeks to support and what weaknesses exist in this area of government. For example in education, the concerns over poor financial management in the Ministry and the general weakness of financial management in schools calls for a diagnostic on the reliability and service levels in the FM system in education and a program of improvement that attends to those weaknesses in practical detail. Annex 3 *[of the main ANS report]* is intended to indicate the situation in each sector through the PEFA methodology as a guide to what these specific capacity building activities should be and where.

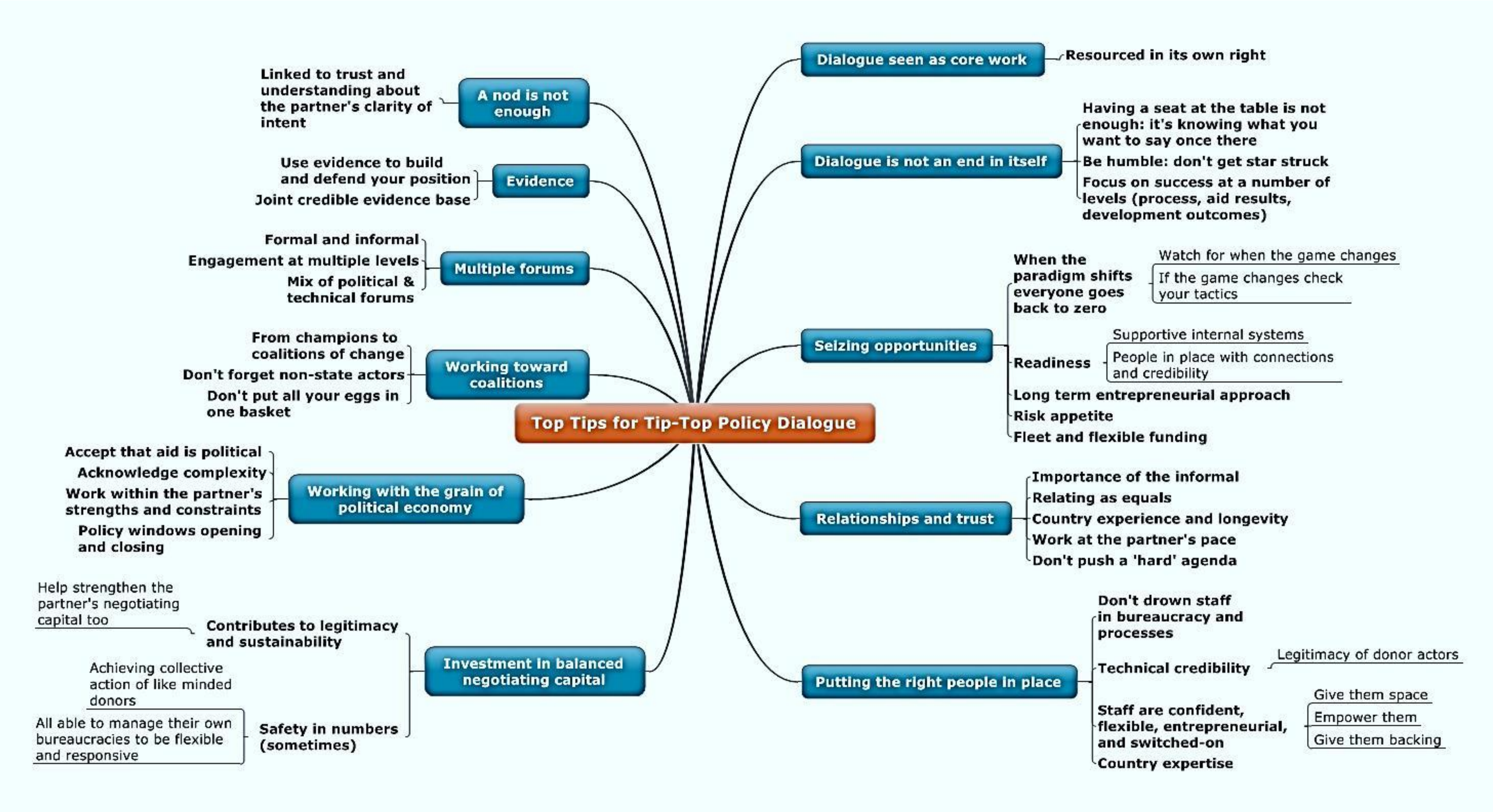
‘On Procurement’

Procurement stands out as very high risk and so donors should be very tentative about relying on the system in its current state. Working within the government system will need a high level of supervision of procurement activities to ensure probity. Practical arrangements to ensure that steps required under GoV regulations and processes are followed (open tenders, standard documentation, transparent process etc.). Where these regulations are not sufficient for a donor even if they are followed (e.g. appeal process) then donors should exercise their individual discretion to impose further requirements. The risks in the area of procurement financed by the recurrent budget are more difficult to mitigate. Hence this area would be of greater concern in the case of any move to more use of the procurement system for non-salary recurrent expenditure, or of repeated use of donor funds to finance relatively small procurements. As it seems unlikely that the imbalance between capital and maintenance expenditure can be resolved without donors supporting the maintenance budgets donors should strongly support the whole procurement process with TA not just the transactions relating to donor capital projects. Full and unqualified use of partner government procurement procedures funded through budget support would have to go along with a significant donor investment in capacity over an extended period.

It is recommended that AusAID not consider relying on existing GoV systems without additional safeguards as discussed above.

Annex 9: ODE ‘Top Tips for Tip-Top Policy Dialogue’

(Extracted from the AusAID Office of Development Effectiveness *Evaluation of Policy Dialogue*, 2012, in press)



Annex 10: GfG's Phase I Interventions

(Data and analysis provided by GfG, May 2012)

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually <u>do</u>?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Telecommunications Reform Approx. $10m 6 years so far	Support the introduction of competition into the telecommunications sector – intended to lower costs and increase access to telecommunications, primarily phones but more recently internet as well. Establish capacity within government for the development and oversight of a National ICT Policy, and transformation of ICT use in government service delivery.	Provided TA and own staff advocacy for negotiation to end monopoly; fund interim regulator and provided grant to World Bank for long-term support to regulator and telecommunication policy; provided seed funding for setting up UAP Fund; funding for technical and policy support in rescuing GoV investment; setting up of OGCIO in government through advocacy at highest level plus funding support via MFEM grant. GfG's role was beyond funding – part of the negotiation team and development of policies and provided advice to GoV in the reform process.	Introduction of a regulator to monitor competition. Established the Universal Access Services fund to ensure access increases, reliant on the passing of a Universal Access Policy. Reduced direct ministerial control over commercial activities in the sector and divesting GoV's shareholding in the previous monopoly through a negotiated settlement. All functions under information and communication technologies transferred to the Prime Minister's portfolio. Signifies relevance and importance of the i-Gov investment. OGCIO has the mandate to manage the network but also set policy direction for GoV on all ICT matters and investments.	Mobile phone access has increased to approx. 90% of the population, with an estimated increase of 1% GDP. The program is close to being fully embedded in GoV systems but given early stage of new governance arrangements (including with regulator and government interface) will require ongoing policy and technical support on the part of GfG to nurture gains

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Power Sector Reforms Approx. $5.5m 6 years so far	Reduce the high cost of electricity by introducing sector regulation and a competitive tender process for Luganville electricity concession (increase diversity of service providers).	Work with World Bank (under Trust Fund) to advocate and establish the utility regulator. Provided TA and funding for establishment and development of new department of energy to take lead on policy development (similar to situation in telecoms). Undertook scoping mission on Luganville concession and Sarakata fund which led to tender of Luganville concession. Provided grant for TA to support GoV in the tender of Luganville concession. Provide advice to GoV on outcome of tender and support GoV officials on the outcome of the tender.	Introduction of competitive tendering (new in the power sector). Introduction of a regulator intended to monitor prices and dilute the price impact of monopoly concessions.	Mixed. Competitive tender in Luganville resulted in a new concession holder and new market entrant. Prices have been reduced by 4.7% across the board following tariff reviews and 49% reduction for low-income consumers. New department of energy created (first time a dedicated policy area for energy in government) but staffing of new department not forthcoming. AusAID support (funding and policy/advocacy) has seen greater engagement of World Bank in a sector which has improved diversity of advice and access to technical support. Reforms remain the subject of ongoing legal challenges. Ministry policy position somewhat uncertain.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Rural Electrification & Lighting Approx. $1.5m 4 years so far	Contribute to GoV's objective of increasing access to off-grid electricity by 25% by 2012.	Provided funding and advice on design of a rural electrification program and rural energy policy. Work with MLNR and NGOs to design the Lighting Vanuatu initiative. Provided grant funding for the Lighting Vanuatu initiative. Opened door to private sector delivery rather than usual government approach, along with national approach rather than small standalone approaches.	No change yet, but intention to move away from government delivery to a sustainable private sector delivery approach. Partnership with NGOs to deliver rural electricity services also new for sector, but looks to be effective.	Mixed. Solar lighting products delivered across the archipelago (up to 20,000 households out of a total 47,000 households in the country) with the added benefit of being able to charge mobile phones. Still weak government leadership but private sector options are looking promising for delivery.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Transport Sector Support Approx. $25m 4 years so far	Improve quality of roads to increase school attendance, health outcomes, and economic and employment opportunities. Improve access to national infrastructure network by supporting better planning and investment links with other transport infrastructure investments in aviation and ports.	Procurement and management of a managing contractor to have oversight of the implementation of the works under phase 1. Provided Grant funding of $18.9m for the rehabilitation and reconstruction road works. Provided policy and strategic advice to both government and managing contractor through the Transport Sector Coordinator and other GfG staff in areas of road, air and sea transport. Provided TA support to areas outside of the technical expertise of the TSC, specifically in aviation and maritime/port reform. Ongoing management advice and support to newly appointed Director of the PWD. Ongoing maintenance of relationship with DG and Minister of MIPU. Provided TA to support broader institutional reforms within the MIPU in areas of public financial management, procurement, contract outsourcing and supervision of works.	Improving the processes and management of the Public Works Department is intended to give Vanuatu a functioning program of works maintenance for the first time, with efficient fund allocation and service delivery. Support to government moves towards outsourcing to increase capacity for works and improve efficiency.	Mixed. Morale and institutional capacity within PWD is improving but staff shortages remain acute (30%). Roads are being rehabilitated (156km in phase I), but the challenge will be government budget to maintain even the roads currently under construction. Program will part fund maintenance as part of program. Private sector (both small and national) now fully engaged in policy process and development support via the project now also explicitly involved in private sector capacity building.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Ministry of Finance & Economic Management (MFEM) Support Approx. $8m 6 years (plus the ten before under the ISP)	Strengthen budget processes, improve public financial management systems, revenue /tax system; procurement; strengthen transparency and accountability and improve management of Government Business Enterprises.	Provided grant for TA to MFEM. Actively involved in the recruitment and oversighting of the TAs and other investments under this grant. Provided TA (PFM Coordinator) to assist with strengthening the PFEM Act by making amendments and provide strategic economic and financial management advice to GoV Work with MFEM in redrafting of DoFT structure and assist with recruitment. Significant ongoing effort invested in maintaining sound fiscal and budget discipline within central agencies (Department of Finance and Treasury)	Implementation of an integrated budget helping to strengthen the link between financial reporting and budget allocations, and critical amendments to Public Financial Management and Accountability Act, have strengthened transparency and accountability. Major new investments in policy and technical support in revenue, procurement and internal audit processes supporting reorganisation of ministry structure and budget allocations.	Mixed. There have been demonstrable improvements at the central level in the administration of public finances such as improved budgeting; improved regulation; improved financial reporting; strengthened expenditure and financial controls; improved revenue forecasting; ongoing system maintenance and upgrades of the Government's finance and budget systems. Major reforms now starting in revenue and procurement functions. There has been limited impact in improved service delivery or quality of public expenditure at the line agency level and the more aggressive linking of MFEM with line agency finance capacity will need to be a feature of the next phase of the program..
Financial Services Bureau (FSB) (Under MFEM)	Enable MFEM representation in the provinces and ensure local/provincial government have access to financial information and advice	Undertake scoping missions and report to GoV on feasibility of FSB Helped GoV in establishment of FSB in three(3) provinces and gradually to other two provinces	Decentralisation / local service provision	Program has been much slower to roll out due in large part to MFEM inability to attract staff to the FSBs in the provinces. Likely that physical offices will be less than anticipated with more hub and spoke arrangement coming in.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Reform of State Owned Enterprises (SOEs) (Under MFEM)	Prevent budget leakage to non-economic state owned enterprises. Remove economic bottlenecks due to poor functioning of some SOE's.	Provided TA to GoV on reforms in Air Vanuatu and VCMB GfG was part of the taskforce in the reform of VCMB.	Intended to support GoV to close down loss-making / dysfunctional SOEs which continue to draw public funds without any clear investment rationale.	Work on the Vanuatu Commodities Marketing Board and Air Vanuatu has led to some promising reforms but progress continues to be linked to political circumstances. A need to engage opportunistically will remain.
School Grants (Under Education)	Eliminate school fees in order to provide free education for all ni-Vanuatu (and thus increase enrolment). Intended to increase number of students attending school (through removal of cost barrier) but quality of teaching issues dependent on reforms within MoE.	Provided TA to MFEM to support the establishment of the school grants; actively involved in the writing of manual and training of MoE staff on the manual. Now managed out of AusAID's education program.	Universal (fee-free) access to primary schools for all ni-Vanuatu	Increase in enrolments by 7% in first year and 8% in total to date. Concern is that ongoing poor management of the grant and related policy by MoE is resulting in deteriorating quality of schooling and reversal of initial boost to attendance due to reduction of fees.
Procurement Reform (Under MFEM)	Increase the number of tenders going through the central tenders board and increase the effectiveness of the tendering process to reduce costs and increase efficiency of process (encouraging compliance).	Provided TA to review the current procurement framework; provided grant to procure TA services for reform of the procurement system. Actively involved in the procurement process and recruitment of the TA.	The use of the tender board for non-donor funded projects is a substantial shift from existing practice and reflects a major shift in GoV use of their own systems.	Government has now endorsed the diagnostic done by the TA and engaged the services of a consulting company to support them in the reform process. Steering committee under the DG MFEM established to manage the process.
Auditor General Support Approx. 400,000 12 months	Increased capacity in OAG to deliver its audit requirements.	Provide Senior Audit TA and grant to OAG to assist in HR reform and outsourcing of audit capacity.	Increased audit products for public accountability and active OAG.	Have now completed all outstanding audits of government accounts back to 2005. Public accounts committee now meeting regularly for the first time in 5 years.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Customs and Revenue Support (Under MFEM)	Support increased revenue collection through greater compliance in VAT and customs collection.	Brought in TA through the Pacific Financial Technical Advisory Centre.	Improvements in revenue collection and greater compliance in collections.	Government VAT collections up 15% on same period in 2011, directly attributed by government to the support of the TA (despite a drop in overall economic activity over the same period).
Major Projects Unit 9 months (Under MFEM grant)	Ensure delivery of significant projects.	No support provided yet but planned to provide grant to increase capacity and operational costs.	Establish a system to manage major infrastructure investments that could give GoV and donors confidence in the effective use of public monies.	Unit has been established formally and steps now underway to support ongoing management.
Tourism Campaign $600,000 grant 2 years	Help boost tourism numbers through support to develop an advertising campaign which was used in Australian and NZ.	Provided grant funding and one long term TA to manage the project. Assisted the institution with working through GoV systems to meet its obligations in administering the funds, procurement of a major international advertising company using GoV contract.	Established a new brand for Tourism Vanuatu and a new website and office for the Tourism Office.	Anecdotal evidence suggests project did help minimise drop in tourist numbers due to economic crisis but broader issues affecting tourism now more of a binding constraint.
Financial Inclusion / Access to Finance NBV Support $500,000 grant for satellite and $860,000 grant for below 2 years	Increase the range of products in rural areas and increase financial literacy Speed up transactions in rural areas and improve business environment. Development and implementation of Financial Inclusion Strategy.	Provided grant funding.	Make banking more accessible, provide more opportunities to start up small business, and enable greater access to loans and micro-financing schemes in rural areas. Roll out a program of products and activities by the Bank to implement their financial inclusion strategy across the country.	Over 7000 new rural bank accounts established as a result of this support. Roll out of mobile banking in 2012. Operational costs of NBV reduced helping manage the bottom line of this well performing SOE.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
i-Government (See above, funding via MFEM grant)	Increase the effectiveness of I-Government in improving cost and time efficiency in government operations and increase data security.	Used MFEM grant to support initiative to integrated i-Gov network, and establish VOIP network over entire i-Gov system.	Reduce cost of telecommunications within entire GoV system ($4m per year). Enables utilisation of video conference calling in most provincial HQ countrywide.	Government is progressing towards full access to provincial offices at no cost due to savings. Without GfG support government would have a $30m debt for a national asset (the $30m loan for the government network) that it could not use effectively. Now it is a national asset.
Urban Development Program (including PPTA) Approx. $1m 12 months	Increased attention on urbanisation issues and investments for functioning urban centres.	Grant to ADB for preparation and physical infrastructures in Port Vila	Increased infrastructure investments in urban areas resulting in greater attention on urban issues	Development of design documents and policy engagement on conditions for project commencement already leading to good reform outcomes (staffing in MIPU, establishment of VPMU). Significantly increased government engagement on urban development issues.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
National Statistics Office Approx. $200,000 1.5 years	Strengthen the capacity of the Statistics Unit to conduct outreach with the aim of ensuring that data are being used to inform decision making.	Assisted to establish a twinning relationship with the Australian Bureau of Statistics (including a program of training and advisory support) TA support to the M&E section of the VSO. Grant funding to establish the information coordination and dissemination unit of the VSO. Ongoing talks on establishment of an integrated information system/database (health, demography, geographic, education, and infrastructure) for the entire GoV through the coordination unit.	Intended effort is to strengthen VSO's ability to disseminate credible and up to date data and information to clients and policy makers, to achieve the outcome of a better informed public sector, and more importantly, better informed policy makers.	This support has led to the rebasing of the Consumer Price Index and national accounts. Future support will come via new regional AusAID stats initiative with the ABS.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Public Service Review Short input Minimal cost	Review the state of Vanuatu's public service to identify potential avenues for reform. Weaknesses in the public sector are seen as a major barrier to wider GoV reform.	Provided TA support and program staff support in rolling out a nationwide survey for all public servants Consolidated report developed and new performance management system developed – yet to be utilised by PSC.	To date, some of the reform recommendations have been undertaken, however the core reform of the performance management system which would have an effect on overall staff performance and effectiveness has not been implemented.	The survey identified numerous challenges in a number of areas including human resource management, workforce planning, and widespread performance management issues. In February 2010, the PSC held a successful public forum to share findings and proposed forward actions although limited progress has been made in building on this momentum. Little has changed as a result and the PSC remains a candidate for targeted long term support given the scale of its problems and importance to the effective running of government.
Maritime Approx. $2.5m 4 years so far	GfG has supported management reforms and the design of a new port facility to decrease the high cost of shipping and improve the trade and business environment . Also working with government, other donors and private sector on maritime charting and hydrography upgrades	Provided grant for development of a bankable proposal for loan financing and TA for the management of the port. Assessment of assets at Luganville wharf.	Efficiency and well run port operations and reduction in stevedoring charges which can be passed on to consumers and reduce cost of doing business	Policy on maritime regulation, in particular management of the major concessions of the international ports, now under review. Will potentially lead to first phase of port reform in Vanuatu.

Topic of intervention or involvement	What was the intended purpose and rationale?	What did GfG actually do?	What, from an *institutional* perspective did the intervention set out to achieve?	What was the outcome?
Aviation Approx. $1.8m 4 years so far	Improve operational performance of Air Vanuatu; ensure safe operation of the 3 AVL airports; improve outer island air safety.	Support to CAAV, AVL and Air Vanuatu in TA provision (audit, operational issues, safety). High levels of policy and operational advocacy with all levels of government. Some small catalytic investments (lights on Tanna; Bauerfield runway repair).	Air Vanuatu management remains fragile but program engagement with them and others (including the board) has helped them to manage soundly. AVL management stability and capacity a concern looking forward. Support to and engagement with CAAV should also help strengthen their capacity and standing.	Development and imminent passing of first ever national standards for outer island airstrips opens way for major investment and maintenance programs for the first time and should see improved safety (and possible rationalisation of airfields) in the next couple of years. Scoping of engineering works required for AVL airstrips will also enable subsequent critical investments to roll out.

Annex 11: GfG's Phase II: First-Year Commitment and Pipeline Budget

(Data and analysis provided by GfG, November 2012)

Topic of intervention or involvement	What is the intended purpose and rationale?	What will GfG do?	What, from an *institutional* perspective will the intervention set out to achieve?	What is the expected outcome?
Program Management and Operations Up to $4m over four years ($700,000 for the 1st year – 12/13)	To enable effective program operation and responsive, high quality policy and programming advice to GoV and AusAID.	In addition to core staff and office/program running costs, the funds will be used to engage two full time in-house advisers (PFM and Economic Advisers) in addition to the current infrastructure adviser. Core staff and advisers are the front line of policy and programming support to GoV under the program and are responsible for both direct engagement as well as sourcing additional resources as required.	GFG staff/adviser engagement will aim to achieve demonstrable policy and institutional development results through high quality, responsive and flexible advice. Also to support AusAID's broader program in economics and public financial management.	A well-managed program delivering demonstrable results in line with GFG Phase 2 design, Partnership for Development, relevant national and sector level policy objectives of the GoV and the GFG design. Consistent positive feedback from GoV on contribution of program.

Topic of intervention or involvement	What is the intended purpose and rationale?	What will GfG do?	What, from an *institutional* perspective will the intervention set out to achieve?	What is the expected outcome?
Support to Prime Minister's Office $3m over four years ($750,000 for 1st year – 12/13 broken down as $250,000 to DSPACC/SLO/PSC/VPMU and $500,000 to OGCIO)	To support the PMO agencies of DSPPAC, SLO, PSC and VPMU to develop/refine their corporate planning, budgeting and human resource management to perform more effectively their mandated roles. To support directly their capacity through engagement of technical or specialist support. To strengthen whole of government coordination with other central agencies, line ministries and provincial offices. To improve GoV oversight of ODA flows. [Policy and technical advice focus] Support institutional, policy and technical capacity within OGCIO (and elsewhere is government as decided by OGCIO). Includes development and oversight of a National ICT Policy, and transformation of ICT use in government service delivery, CAPEX for software/systems infrastructure/applications development/training. [Policy, technical and programming/investment focus]	Develop grant agreement with PMO to support the core operations of the PMO agencies in delivering their mandate. GFG staff/advisers will then maintain regular engagement with PMO agencies to provide support on effective use of the grant resources against agreed annual work plans or other uses as they arise. Given the diversity of agencies under the PMO, and the centrality they play in effective government business (e.g. SLO, PSC), the timing and scope of grant use will need to be developed over time and is unlikely to be specified in the first year.	An active and strong Prime Minister's Office whose agencies are performing against their respective mandates. A functioning OGCIO supporting whole of government in utilising its I-Government, staff well with policy and technical resources. Government policy and programming in the sector benchmarked at top of regional performance.	An effective Prime Minister's Office that plays a proactive policy coordination role across government and with donor partners. Provision of accurate, frank and timely policy and programming advice to the Prime Minister. Improved whole of government coordination around development policies, planning, monitoring, and scrutiny of budget proposals – with PMO giving constructive and sound advice to line ministries and to the Council of Ministers. Stronger link between planning and budgeting – with sector plans being costed, and the PMO giving sound advice on NPPs. ODA flows increasingly reflected in GoV budget, reports and plans. Major projects managed by the VPMU on target and within budget. Government ICT systems benchmarked as top of regional performance. Best practice ICT policies and regulations in place and being implemented with the support of a competent and supportive regulatory environment. Genuine competition in service provision across all major categories in the ICT sector.

Topic of intervention or involvement	What is the intended purpose and rationale?	What will GfG do?	What, from an *institutional* perspective will the intervention set out to achieve?	What is the expected outcome?
Support to Ministry of Finance and Economic Management $2.25m over four years (No funds in 1st year – 12/13 as existing Phase 1 grants rolled over will be sufficient)	To strengthen budget processes, improve public financial management systems, revenue/tax system; procurement; strengthen transparency and accountability and improve management of Government Business Enterprises.	Provide core funding support to assist MFEM agencies (DoFT, VNSO, Tender Board Secretariat, Dept. of Customs & Revenue) to procure technical assistance, goods and services in support of operational and reform oriented activities.	To ensure MFEM remains a strong institution and agencies such as DoFT, Customs and Revenue, Tender Board Secretariat and VNSO perform at or above their corporate objectives. To support the agencies to develop/implement new reforms which improve revenue flows and expenditure management. That MFEM improves its outreach to the line agencies and the public in order to improve quality of public expenditure and accountability/transparency of PFM and budget management.	Ongoing improvements in administration of public finances including improved budgeting (target setting, forecasting, expenditure management); improved regulations (adoption rates, compliance); improved financial reporting (including public accessibility); strengthened expenditure and financial controls; FMIS maintenance and useability upgrades (including line agency training). Medium-term fiscal framework developed together with PMO. Finance units of line ministries and provincial offices are strengthened – including internal audit functions. Procurement reforms are approved and implemented across whole of government. Increasing percentage of government expenditure through Central Tender Board processes. Improved/streamlined revenue and customs regulations and more compliance resulting in increased revenue collection Improved data collection, compilation and dissemination to stakeholders throughout Vanuatu, including government.

Topic of intervention or involvement	What is the intended purpose and rationale?	What will GfG do?	What, from an *institutional* perspective will the intervention set out to achieve?	What is the expected outcome?
Support to Telecommunication Sector $2.73m over four years ($1.5m in 1st year – 12/13)	Support the consolidation of the telecom regulator office as a self-sustaining, competent and well regarded institution within government, industry and consumers. To ensure the telecommunications sector fosters genuine competition in key market segments driving lower costs and improved access and quality of telecommunications services	Provide core funding to the Telecommunications Regulator Office via the World Bank Trust Fund to help consolidate telecommunication regulation in Vanuatu. This support will also support some activities in the OGCIO and ensure the GoV can still access World Bank expertise.	Better regulation and effective regulator driving reduction in prices and increasing good quality access throughout Vanuatu	Reduced costs of telecommunication services (phone and data) Increased access to telecommunication services throughout Vanuatu (phone and data) Competitive private sector provision in all key market segments in the sector High quality and well regarded policy and technical advice to the GoV as requested.

Topic of intervention or involvement	What is the intended purpose and rationale?	What will GfG do?	What, from an *institutional* perspective will the intervention set out to achieve?	What is the expected outcome?
Support to Energy Sector $1m in 1st year 12/13	To reduce the cost of grid based electricity through effective regulation To improve access to electricity across the country (off grid)	Funding World Bank (under Trust Fund) to provide technical assistance to URA/GoV. GFG staff to also provide policy/technical support to the World Bank, URA and GoV (Department of Energy) in the development and implementation of sector policies and regulations. Implement the VERD program which will be delivered via the private sector (in support of GoV policy oversight) to deliver subsidized small to medium scale renewable energy systems to public institutions, businesses and household across the country. Support review of lighting Vanuatu initiative and engage long term monitoring program (with GoV) to track rural electrification rates. Support implementation of GPOBA program with World Bank to work with industry (on grid) to reach 100% access for within grid residents	Improved impact from regulation including industry compliance, government and consumer support/engagement. Contract signed for management of VERD program to support GoV and private in implementation of GoV energy roadmap outcomes	Reduced/capped growth in electricity costs on grid Significant increase in electricity access rates in non-grid areas (from 2009 baseline)

Topic of intervention or involvement	What is the intended purpose and rationale?	What will GfG do?	What, from an *institutional* perspective will the intervention set out to achieve?	What is the expected outcome?
Support for Implementation of Trade Policy Framework $270,000 already allocated from 1st year - 12/13 flexible fund	Ministry of Trade, Commerce, Industry and Tourism (MTCIT) able to effectively implement Vanuatu's Trade Policy Framework (TPF)	Provide grant funding to MTCIT for the recruitment of technical/activity assistance to support the implementation of the Trade Policy Framework and its implementation matrix. Participate as the donor facilitator in the implementation of the Trade Policy Framework	Establish within GoV the TPF as the guiding trade policy and the NTDC as the principal decision-making and planning body.	GoV able to successfully engage in trade negotiations and have the required policy and implementation expertise to take advantage of trade agreements. GoV trade related planning and implementation activities planned and coordinated effectively via the MTCIT/TPF/NTDC framework.
Support to Office of the Auditor-General (OAG) $250,000 already allocated from 1st year – 12/13 flexible fund	OAG has the capacity to undertake its audit mandate.	Provide Senior Audit TA and grant to OAG to assist in HR reform, capacity building and ability to outsource tasks/activities as required.	Increased number and quality of audits being produced. Effective and proactive secretariat support to the PAC/parliament. Increased internal staff capacity to undertake audits and support development of national audit policy and legislation.	All government audits up to date (including backlog). Public accounts committee meeting regularly as benchmarked against previous years. Increased number of ad hoc audits (including of development projects) being undertaken under the coordination of the OAG. Increased public awareness of OAG audits and functions.
Knowledge, Analysis, Research Briefing $1,050,000 ($300,000 in 1st yr)	To enable the program to generate, publicise and disseminate analytical products that support GFG result areas	Commission specific research activities including providing specific grants to research institutions to undertake the research analysis.	Working closely with the PMO and VNSO to increase the quality and usefulness of analysis and research to influencing government policy making	Increased availability of evidence-based and informed research products that demonstrably influence policy formulation and implementation. Increase demand at political level for good quality and timely research and analysis.

Topic of intervention or involvement	What is the intended purpose and rationale?	What will GfG do?	What, from an *institutional* perspective will the intervention set out to achieve?	What is the expected outcome?
Support to Aviation Sector $500,000. 12-13 only	To assist the Vanuatu Government design and install lighting equipment for three airstrips in Vanuatu (Pekoa, Bauerfield & Whitegrass)	Procure consultancy services to design and project manage installation of the lighting equipment		Improved airstrip safety. Access to Tanna for night flights increasing night landing options (safety) and tourism opportunities
Unallocated (Flexibility) funding $8.4m over four years $1.2m in 1st year – 12/13	To provide ability to support expansion or deepening of activities in support of achievement of result areas.	Using in-house and external resources, GFG will work closely with GoV and other partners to identify, develop and support initiatives which will deliver tangible results against the program's result areas. To respond quickly, flexibly and effectively to emerging GoV initiative and reforms which align with the GFG result areas.		Measurable progress against all key result areas.