

# PAPUA NEW GUINEA

ANALYTICAL REPORT FOR THE WHITE PAPER ON  
AUSTRALIA'S AID PROGRAM

Prepared by  
Alan Morris and  
Rob Stewart

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## Executive summary

### *Overview*

Papua New Guinea (PNG) faces enormous development challenges. The country continues to confront difficult economic circumstances, there is widespread breakdown in service delivery and the economic and social impact of the emerging HIV/AIDS crisis will intensify in the next three to five years. PNG has the worst social indicators in the Pacific, and its human development indicators remain poor relative to its per capita income.

PNG's population has almost doubled, from 2.9 million at Independence, to 5.5 million in 2003, growing at an average rate of around 2.7 per cent per year. Forty-one per cent of the population is under the age of 15. The country's rapidly growing population is adding significantly to the burden of delivering essential social services. The emerging HIV/AIDS epidemic could have a substantial impact on population growth in the period ahead.

Women are particularly disadvantaged with lower life expectancy, significantly lower participation in the education system and high rates of maternal mortality.

Trend growth slowed from around six per cent per annum in 1960 to around two per cent in 2002. From 1991 to 1994 the economy grew rapidly, largely due to strong performance in the petroleum and mining sectors. Between 1995 and 2002 the economy contracted in all but two years. High inflation and rapid population growth meant that per capita incomes fell an estimated 18 per cent between 1994 and 2002. In US\$ terms per capita income in 2003, at US\$510, was substantially less than it was in 1975 (US\$560).

The 2005 National Budget projects growth to continue over the next five years, with non-mining real GDP growth forecast to grow by 2.8 per cent in 2005 and from three per cent to 3.5 per cent over the period 2006–2009. With the projected rapidly increasing population, economic growth of around three per cent will be insufficient to yield significant increases in per capita incomes over the medium term.

PNG's fiscal outlook will remain constrained for the foreseeable future. Funds available for the delivery of goods and services are likely to diminish beyond current levels—levels already inadequate to meet the reasonable needs of the population. PNG's capacity to improve standards of service delivery across the country over the next five years is expected to decline, not strengthen.

PNG's medium term economic outlook is uncertain. Current economic recovery is fragile and significant endogenous and exogenous impediments to higher levels of sustainable growth remain. Developing broader sources of growth, particularly in rural areas where the majority of poor live, must be a priority if PNG is to make real gains in addressing its poverty problems.

Eighty five per cent of the population live in rural areas. The rural population grows almost all its own food, and uses money from the sale of cash crops to meet some proportion of education and health care costs. This is an important source of stability to the nation and provides employment to a large number of the work force, including, importantly, large numbers of young men.

Village agriculture is also important to the overall stability of PNG. Even on the most favourable assumptions about growth, village agriculture will continue to sustain the overwhelming majority of Papua New Guineans for the foreseeable future.

### ***Positioning the aid program to support growth***

Clearly defined strategies for growth, backed by consistent implementation of priorities to generate it are required. Lack of strong and consistent linkages between the last Medium Term Development Strategy 2005-2010 (MTDS) and the annual budgets undermined the effectiveness of the MTDS process. At this time, and notwithstanding the emphasis given to growth in the MTDS, specific strategies, assurance of funding, and commitment to implementation are inadequately developed.

The PNG Government supports developing infrastructure, particularly roads (but also communications, airports and sea ports), as a key priority in generating stronger growth. Adequate infrastructure to link people and products to markets is a precondition for growth and should be a strong focus of the aid program. Improved infrastructure also facilitates access to better services, particularly for the rural majority.

Generating sustained broad-based growth cannot be achieved without a focus on overcoming the constraints which hinder wider growth opportunities. Attention on binding constraints is a must. The aid program must support the identification of priorities and work in concert with the Government and other donors, to support the effective and consistent implementation of initiatives to address them.

### ***Positioning the aid program to support political governance***

PNG is still a young nation and the integration of its fledgling formal institutions with pre-existing social forms is far from complete. The impact of interventions to strengthen governance will be gradual and long-term. Expectations should be realistic.

PNG has many institutions designed to support effective governance. They are generally weak and are given little committed support or effective follow up.

PNG church agencies provide around 40 per cent of school education and 45 per cent of health services across the country. Many in Australia and PNG ask whether aid should be supporting non-government organisations (and, in some cases, the private sector), to play a stronger role as alternative channels for service delivery and/or as agents to demand greater transparency, accountability and stronger performance from Government.

With the exception of churches, non-government organisations in PNG are not large or well organised. Their reach—geographic coverage and sectoral involvement—is limited. Community organisations can undoubtedly provide effective service delivery in pockets, but none offer wide-reaching delivery networks. If given a much more demanding mandate, there is little reason to believe they would not end up suffering from the same weaknesses as government systems, including weaknesses in governance.

More widespread use of NGOs in service delivery would weaken the pressure on Government to perform and would leave Australian aid at the sharp end of service delivery. It is logical to view these organisations as important and valuable partners of government and donors in a more effective service delivery network, and to support

them in areas (geographic and sectoral where they demonstrate strengths, but not as alternative networks which might replace government systems.

As an issue of political governance, arrangements under the 1995 Organic Law on Provincial and Local Level Government need to be reviewed. Implementation of the Organic Law provisions has been haphazard and inconsistent. Confusion remains over responsibility for many functions and funding arrangements have proven unaffordable and inequitable. This has led to large inequities between provinces, weak governance and deteriorating service delivery.

### ***Positioning the aid program to support stability***

Strengthening the cohesion of the nation will rely on consolidating the legitimacy, relevance and authority of the National Government. The relevance of the National Government to the people depends on how well the Government is active and contributes to their well being by delivering basic services.

While there will be opportunities for specific interventions to promote peace and stability, the most effective on-going response of the aid program to issues of instability is to support stronger broad-based growth, improved service delivery and more effective governance (that is, to strengthen the capacity of the state to meet the needs and aspirations of the people).

### ***Implementation of the aid program***

The fundamental questions confronting the aid program over the next five to ten years are why PNG's economic and social progress has been so disappointing, why governance remains weak, and whether Australian aid can provide more effective support for stronger outcomes.

### **Size and reach of the program**

Arguably, the breadth of the aid program, with its reach into nearly all sectors of activity, has undermined rather than underpinned improvement in some respects. In some sectors, and some parts of the country, the availability of aid interventions has encouraged the substitution of aid for the use of PNG's own resources, allowing the latter to be diverted to other, often lower priority, uses. The breadth of the program may also have contributed to a failure to leverage stronger overall performance by the Government of PNG. The flexibility of the program (which, in part reflects its size), and a genuine and well-intentioned willingness to respond to emerging issues of need, has generated expectations among some groups in PNG that aid resources are available if representations are made. Australia is not responsible for service delivery, or particular outcomes in PNG. The only effective and sustainable contribution of the aid program is to complement and support the work of the PNG Government in meeting its responsibilities and objectives, not to supplant it.

A clearer focus for the Australian aid program (and in this context 'clearer' means 'narrower'), coupled with firm governance arrangements, would require more focused commitment by the PNG Government, and should facilitate the stronger involvement of other donors who may be better placed to deal with particular aspects of the challenges associated with promoting growth.

## A compact

Going forward, an essential feature of the aid relationship must be that aid works effectively with PNG's own resources and support agreed objectives and priorities. A carefully constructed compact which clarifies the role the aid program is to play in supporting PNG efforts—and the responsibilities which the Government will meet through its own efforts—would provide much needed clarity.

## Good enough

The aid program needs to reflect good enough principles in its design, implementation and expectations. Arguably the program in the past has been too ambitious, too broad and sought to progress too many objectives without regard to sequencing to support the most important priorities.

## Central agency engagement

PNG cannot effectively address its challenges without the central machinery of government driving a coherent and affordable agenda. The design of the Enhanced Cooperation Program (ECP) recognised the importance of central agencies and the machinery of government. While the immediate outlook for ECP is unclear, the aid program must continue to engage with central agencies as an essential ingredient to improved performance

## Modalities

Consistency is important in selecting modalities—the way aid interventions are designed and implemented. Frequent change creates confusion and uncertainty. The reasons for and benefits of change may not be embraced as quickly within PNG as within Australia.

### *Implications for the aid program: Drawing these together*

Three fundamental conclusions should inform the future direction and positioning of the aid program over the medium term:

1. PNG must generate stronger economic growth
2. service delivery needs to be improved
3. governance must be strengthened.

Growth at nearly double the rates currently projected in the PNG Budget for the coming years is needed if poverty is to be reduced. Growth needs to be broad-based to maximise the impact on the lives of people across the country and to strengthen the Government's fiscal capacity to contribute effectively to the economic and social advancement of Papua New Guineans. Carefully prioritised programs and consistency of implementation are also required. Overcoming constraints to growth is the key. The aid program must support growth if the PNG Government's capacity to deliver improved services is to be strengthened.

Governments at all levels in PNG must work to improve service delivery. This requires a stronger fiscal position overall, greater equity in access to funding for service delivery, more effective operation of the decentralised service delivery framework, identification of priorities, and stronger and more consistent commitment.

Improving the enabling environment, strengthening governance and generating stronger growth are interdependent.

PNG faces huge challenges and costs in providing services, but more could be done with available resources. The inefficient, ineffective and inconsistent use of existing resources is preventing better outcomes.

### **Supporting stronger broad-based growth**

A strong focus is required to address the binding constraints that have inhibited PNG's growth performance. Priorities should be:

- A stronger focus on infrastructure. This is consistent with PNG's own priorities as set down in the MTDS, but greater clarity is needed on the contributions of donors and PNG, including for infrastructure maintenance.
- Other binding constraints. A manageable and carefully prioritised program of sequenced initiatives is needed to address those constraints which impede growth and development. This can only be achieved with the full cooperation of, and within the limits of, all parties. A joint technical economic team, with representatives from PNG, Australia and possibly other donors such as the World Bank, could conduct a critical path analysis outlining what is required to address constraints to growth, consistent with MTDS objectives. Genuine partnership and PNG Government commitment to implement the outcomes of such a critical path analysis would be essential.

In supporting growth, the aid program must work in concert with other donors and draw on the comparative advantage of different donors, particularly the development banks. Critically, it must work in concert with the Government of PNG and its use of its own resources. Clear priorities and expectations need to be established, supported by consistent implementation.

### **Supporting PNG's efforts to improve service delivery to the most vulnerable, but with reduced exposure to, and involvement in, service delivery generally**

A stronger focus on supporting growth will require reduced and more focused support for service delivery. This implies that PNG must accept greater responsibility for service delivery generally. Priorities will need to be agreed and implementation monitored. Consistency and long-term support are required.

### **Working strategically to improve governance**

Interventions should recognise and reflect the practical reality of good enough governance. This means identifying key priorities and focussing on practical issues, particularly strengthening the machinery of government.

The arrangements and functional responsibilities under the 1995 Organic Law on Provincial and Local Level Government need to be re-examined. The current decentralisation framework has contributed substantially to deterioration in service delivery, lack of transparency and accountability, and weak performance.



## **A compact**

There is a need for greater rigour in monitoring and evaluating aid effectiveness. This should be important to both governments. A compact which sets out agreed priorities and mutual commitments and expectations of both governments would provide a framework for consultation, monitoring and evaluation. This would be effective in ensuring that the Country Strategy, when finalised, was appropriately operationalised.

## **Consistency and patience**

Australia's commitment to long-term engagement with PNG must come with consistency and patience. There are no quick fixes. Frequently changing priorities undermines confidence and generates confusion. This in turn weakens prospects for positive outcomes. Unrealistic expectations similarly generate counter-productive frustrations.

## Chapter 1: Development overview, outlook and context

### Snapshot of development progress and medium-term outlook

#### *Overview*

PNG faces enormous development challenges. It has a vibrant although volatile democracy and the task of building nationhood, particularly given the extremely fragmented nature of PNG society, remains complex and challenging.

Despite recent economic relief from strong commodity prices the country continues to face difficult economic circumstances. There is widespread breakdown in service delivery and the economic and social impact of the emerging HIV/AIDS crisis will intensify in the next three to five years. There are cases of instability, particularly in the Highlands, and crime is increasing. The population will double in the next 20 years. These factors place a premium on generating sustainable broad based growth and employment, which PNG has struggled to achieve.

#### *Current economic situation*

Modest economic growth returned to PNG in 2003 after a sustained period of contraction (1996–2002), in part buoyed by favourable weather conditions and good prices for the country's main exports. However, per capita income in 2003 was less than it was in 1975.<sup>1</sup> Formal employment grew by only 1.5 per cent over the period 1996–2003.<sup>2</sup>

**Table 1: Papua New Guinea—recent economic performance (selected indicators)<sup>3</sup>**

	1999	2000	2001	2002	2003
<b>Income and Growth</b>					
GDP per capita (US\$, current prices)	686	664	553	512	566
GDP Growth (% , constant prices)	7.6	(1.2)	(2.3)	(0.8)	2.0
<b>Saving &amp; Investment (% of GDP)</b>					
Gross Domestic Investment	16.4	13.0			
Gross Domestic Saving	13.3	25.3			
<b>Inflation</b>					
Consumer Price Index (annual %)	14.9	15.6	9.3	11.8	11.8
<b>Government Finance (% of GDP)</b>					
Total Revenue & Grants	29.3	31.6	32.0	29.4	31.7
Total Expenditure & Onlending	31.9	33.6	35.6	33.4	33.4
Fiscal balance (surplus(+), deficit (-))	(2.6)	(2.0)	(3.6)	(4.1)	(1.7)
<b>Balance of Payments (% of GDP)</b>					
Merchandise Trade Balance	25.6	31.9	29.2	19.9	33.0
Current Account Balance	4.2	10.2	9.5	(4.6)	9.1
<b>External Payments Indicators</b>					
Gross Official Reserves (months of imports)	2.4	4.0	6.1	4.2	4.9
External Debt Service (% of exports)	7.5	6.7	7.1	7.4	8.3
External Debt (% of GDP)	43.4	40.3	50.1		

<sup>1</sup> World Bank, Papua New Guinea: Interim Strategy Note, (April 2005).

<sup>2</sup> Asian Development Bank, Country Strategy and Program Update 2004-2006 (January 2004)

<sup>3</sup> Source: Ibid (Appendix 1)

The 2005 National Budget projects growth to continue over the next five years, with non-mining real GDP growth forecast to grow by 2.8 per cent in 2005 and from three to 3.5 per cent over the period 2006–2009. With the projected rapidly increasing population, economic growth of around three per cent will be insufficient to yield significant increases in per capita incomes over the medium term.

The PNG Government has made progress on the public finance front. Fiscal consolidation is being achieved, and a potential descent into debt unsustainability averted. There are encouraging signs of macroeconomic stability, including prudent monetary policy, improved budgetary performance, lower interest rates, appreciation in the exchange rate, and increasing international reserves. There was a small fiscal surplus of around one per cent of GDP in 2004.<sup>4</sup> The Budget forecast for 2005 states that with continuing tight fiscal management, a small fiscal deficit of one per cent of GDP will be achieved. Tight fiscal management is projected to maintain small deficits and surpluses (between -0.6% to +0.3% of GDP) over the period 2006–2009.<sup>5</sup>

PNG's fiscal outlook will remain constrained for the foreseeable future. High spending on public service wages and salaries (including for ghost employees), debt-service obligations, low productivity, and a possible relaxation of fiscal discipline ahead of the 2007 national election will present on-going political and managerial challenges over the coming years. It is a scenario in which funds available for spending on delivery of goods and services are likely to diminish beyond current levels—levels already inadequate to meet the reasonable needs of the population.

### ***Social and human development***

Despite substantial improvements since Independence in some key social indicators, 'overall PNG has the worst social indicators in the Pacific<sup>7</sup> and its human development indicators remain poor relative to its per capita income. PNG will not achieve the Millenium Development Goals (MDG) by 2015.

**Table 2: Papua New Guinea—selected social and development indicators.<sup>8</sup>**

	1970–75	1980–85	1997–2003
<b>Population</b>			
Population (millions)	2.7	3.5	5.5
Population growth rate (%)	2.4	2.6	2.4
Urban population (% of total population)	11.9	13.1	13.2
<b>Poverty</b>			
Number of poor (millions) 1996 and 2005 (using international poverty line—US\$1 per day)	-	-	1.1 – 2.3
<b>Public expenditure (% of GDP)</b>			
Health	-	-	3.9
Education	4.4	-	2.3
Life expectancy at birth (years)	49	53	57
Total fertility rate (births per woman)			
Infant mortality (per 1,000 live births)	90	79	70

<sup>4</sup> PNG 2005 Budget Papers – Volume 1 – Economic and Development Policies, Table A3.10

<sup>5</sup> *Ibid.*

<sup>6</sup> AusAID (2003) 'The Contribution of Australian Aid to Papua New Guinea's Development 1975-2000', p ix

<sup>7</sup> *Ibid.*

<sup>8</sup> World Bank, Papua New Guinea: Interim Strategy Note - Annexes (April 2005).

Illiteracy (% of population 15+ years)	-	-	35
Access to improved water source (% of pop.)	-	-	42
Human development index rank (175 countries)	-	-	132

### *The HIV/AIDS dimension*

The longer term effects of an emerging HIV/AIDS epidemic in PNG could be immense. HIV prevalence in PNG is now approaching two per cent of the adult population.<sup>9</sup> A 2002 report by the Australian Centre for International Economics (CIE)<sup>10</sup> found that if the emerging crisis is not addressed, under a worst case scenario, deaths from HIV/AIDS could reach over 120,000 per year and the workforce could be reduced by 34 per cent by 2020.

As the epidemic progresses it strains education systems, weakens demand, widens the gender gap, and potentially leads to increased costs across all sectors of the economy.<sup>11,12</sup> AusAID's draft HIV/AIDS thematic report states: 'Of most significance to Australia in the next five to ten years is the escalating impact of a generalised epidemic in PNG... Already PNG is losing at least one teacher a week from the workforce due to HIV/AIDS related illness and deaths.'<sup>13</sup>

It seems clear that Australia will need to play a significant role in helping PNG address its emerging HIV/AIDS epidemic, and Australia's *International HIV/AIDS Strategy* (AusAID 2004) commits AusAID to mainstreaming HIV/AIDS across its development cooperation activities. AusAID's draft HIV/AIDS thematic report concludes that an immediate priority should be accorded to elevating the breadth and depth of the response to HIV/AIDS in PNG.<sup>14</sup> However, in PNG, national and provincial AIDS councils have been under-resourced and unable to operate effectively. National government leadership has been mixed on HIV/AIDS and there is need for much stronger coordination among the agencies involved, including donors and NGOs. And for mainstreaming to work, finance and planning ministries that control budgets and negotiate the terms of foreign assistance must have HIV/AIDS as a clear priority.<sup>15</sup>

### *Outlook*

Despite recent positive signs, PNG's medium-term economic outlook is uncertain. The current economic recovery is fragile, and significant impediments to higher levels of sustainable growth remain.

The country faces many endogenous structural and policy issues which inhibit prospects for higher levels of sustainable growth. These include law and order problems, political instability, inadequate and poorly maintained physical infrastructure (particularly

<sup>9</sup> A 2004 PNG Consensus meeting that reviewed surveillance data estimated prevalence at 1.7% of the adult population.

<sup>10</sup> Centre for International Economics "HIV/AIDS in Papua New Guinea" (2002).

<sup>11</sup> AIDS patients already regularly occupy more than 50 per cent of medical ward beds at Port Moresby General Hospital.

<sup>12</sup> AusAID Issues Paper: HIV/AIDS in the Asia Pacific Region – draft of 19 July 2005.

<sup>13</sup> *Ibid.*

<sup>14</sup> *Ibid.*, page 32.

<sup>15</sup> *Ibid.*

transport infrastructure), uncertainty over property rights, limited access to credit, and a limited human capital base (reflecting poor health and education standards). There is strong evidence that the overvaluation of kina between 1975 and the early 1990s had a substantial depressant effect on the development of the agricultural sector.

PNG's small, relatively open, formal economy depends on a limited number of primary commodities and is vulnerable to exogenous shocks. The dominance of a few commodities with fluctuating prices leaves its economic prospects vulnerable to significant year-to-year variation in export earnings with consequential implications for exchange rate movements and inflation. The contribution of the extractive resource sector to growth is projected to decline in the years ahead.

Poor economic performance is reflected in increasing poverty levels. While it is difficult to determine poverty levels with confidence, on the basis of the national poverty line, <sup>16</sup>the proportion of poor is estimated to have increased from 37.5 per cent of the population in 1996 to about 54 per cent in 2003.<sup>17</sup> In terms of international measures of poverty (US\$1/day), poverty is estimated to have risen from about 25 per cent of the population to just under 40 per cent over from 1996 to 2003.<sup>18</sup> While these measures may overstate the extent of poverty, and while recent economic recovery should result in some turnaround in these indicators, it is clear that developing broader sources of growth, particularly in rural areas where the majority of the poor live, must be a priority if PNG is to make real gains in addressing its poverty problems.

## Papua New Guinea's Medium-Term Development Strategy and National Poverty Reduction Strategy<sup>19</sup>

The Medium-Term Development Strategy (MTDS) (2005–2010) is the main planning document of the PNG Government. It adopts a theme to reduce poverty through rural development. MTDS objectives are to be reflected in the National Poverty Reduction Strategy (NPRS), but this however, has not been completed or endorsed.

Assessments of poverty reducing strategies and delivery mechanisms conclude that poverty results from: weak governance; weak social support systems; inefficient use of natural resources; lack of economic and financial growth opportunities; a poorly maintained infrastructure network; and the inefficient delivery of, and lack of access to, basic services. The framework of the Government's NPRS is expected to involve the MTDS's expenditure priorities:

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<sup>16</sup> The national poverty line corresponds to a nutritional norm of 2,200 calories per adult equivalent and also allows for basic non-food expenditure. . The most recent household survey data on which such poverty measurement can be directly based are from the National Household Survey of 1996. . No nationally representative survey of income or consumption has been undertaken.

<sup>17</sup> World Bank, *op cit*

<sup>18</sup> *Ibid*

<sup>18</sup> In May 2005 a Supreme Court of PNG decision found elements of the ECP program were inconsistent with PNG's Constitution.. The decision has required the policing element of the ECP program being suspended indefinitely while the future of the entire ECP program is currently being reconsidered in consultation with the PNG Government

<sup>19</sup> Source: ADB website: <http://www.adb.org/Documents/IndigenousPeoples/png/SIPSA-r35-04-PNG.pdf>

1. basic education
2. primary health
3. transport infrastructure and maintenance
4. law and order
5. income-generating opportunities (especially in rural areas).

## Current aid program

The current Australian aid program comprises A\$300 million per annum in country programmed aid to PNG. Other aid totals an additional A\$192.3 million for financial year 2005–06. The aid program's coverage is extensive with engagement in all five priority areas of the MTDS:

- The key priorities for the A\$300 million of country programmed aid include: fostering sustainable development (transport infrastructure and renewable resources); building stronger governance; developing institutional capacity (governance, law and order, health and education), and addressing HIV/AIDS.
- A major proportion of the estimated additional A\$192.3 million is for the ECP which focuses on weaknesses in administrative capacity, re-establishing investor confidence and providing an enabling environment for broad-based development. The program includes initiatives in policing, law and justice, economic and public sector management, and border and transport security. The cost of the ECP program is estimated at A\$1.1 billion over a five-year period, A\$300 million of which is to be provided out of the existing bilateral aid program. At present, the policing component of ECP has been withdrawn, and the immediate outlook for the remainder of the program is uncertain.

## Lessons learnt from past engagement

AusAID's experience working with PNG has highlighted key lessons on what is required for successful aid engagement, including:

- the importance of local ownership, leadership and early participation of all parties
- clearly understood expectations from the outset
- recognition of comparative advantages
- flexibility to deal with changing country conditions
- the importance of backing genuine reformers in their efforts to strengthen existing institutions
- facilitating a broadly shared understanding of what constitutes an appropriately sequenced reform agenda for public expenditure management
- working with national and provincial government levels, to promote better communication and coordination across government
- the need to focus aid program resources so they leverage the greatest benefits from PNG's use of its own resources in areas of greatest priority
- the need to work in support of partner government systems and policies to produce more sustainable improvements in institutional capacity and service delivery
- the need for patience, particularly on the part of donors, in waiting for successful outcomes

- taking a sector-wide approach where feasible to foster donor coordination and allow national departments to demonstrate and develop leadership and organisational capacities
- combating corruption, which undermines the effectiveness and impact of aid interventions, however well conceived these might be
- the need for robust analysis and evaluation of the appropriateness and effectiveness of aid interventions.

## Role and future direction of the World Bank, the Asian Development Bank and other agency engagement

### *The World Bank and the Asian Development Bank*

In 2002 Australia, the Asian Development Bank (ADB) and the World Bank recognised that the immense development challenges facing PNG called for a different approach from donors and they agreed to work more closely together under the umbrella of a Joint Country Strategy (JCS). The JCS aims to more closely align donor support around PNG's development priorities through joint analytical and advisory services, policy dialogue, and coordinated financing of high-priority investments. By the end of 2003 the PNG Government had disengaged from the development of the JCS as it came to the view that the JCS was an attempt by donors to 'gang up' on the country. PNG's Government also believed it had not been consulted in the JCS process early enough. In addition, by this time the new ECP was complicating the nature of Australia's aid engagement with PNG's Government and other donors. Despite this all donors remain strongly committed to developing a joint approach in aid delivery.

The **World Bank** has indicated its priorities for working with PNG are to help the country realise its growth and poverty reduction potential through better governance, sound economic management, and sustainable natural resource exploitation, while ensuring that the spread of HIV/AIDS is contained.<sup>20</sup> The Bank's Interim Strategy will focus its efforts on: promoting development dialogue and mitigating the decline in social indicators by deepening the relationship with government at all levels; reaching out to stakeholders in broader society, and enhancing coordination with other development partners; and building the foundations for improved governance and sustained recovery through analytical work, selective capacity building and targeted priority investments in basic services.

The **ADB** strategy for PNG (2004–2006)<sup>21</sup> focuses on strengthening governance, supporting private-sector development and improving social conditions. The ADB is strengthening public sector management, particularly in the areas of fiscal and financial management and public service reform. For private sector development, ADB is helping to improve sector policy and institutional frameworks (agriculture and fisheries), enhance factor productivity (skills development and microfinance services) and improve market access by selected transport infrastructure investments, especially in rural areas. In the social sectors, ADB will continue to assist in policy development (health) and to support infrastructure investments (water and sanitation) and service delivery.

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<sup>20</sup> World Bank, *op cit*

<sup>21</sup> Asian Development Bank, *op cit*. The ADB also considers its current strategy should be viewed as an interim strategy in lieu of development of a joint Country Strategy with the World Bank and AusAID.

The potential scope for engagement by the World Bank and ADB is substantial. However, recent decisions by both institutions to scale back their level of engagement following unresolved issues with PNG authorities has resulted in limited operational engagement at present.

### *Japanese aid to PNG*

Japan is the second largest bilateral donor to PNG. The focus of Japan's aid efforts are in transportation and communication, health, education, agriculture, environment, and other areas such as law and order. Japan's Official Development Assistance (ODA) to PNG is delivered through grant aid, concessional loans and technical cooperation assistance provided by Japan's Department of Foreign Affairs, the Japanese Bank for International Cooperation (JBIC) and the Japan International Cooperation Agency (JICA).

Potential areas for joint cooperation include supporting the PNG health sector. JBIC has also suggested better donor coordination, especially regarding the Highlands Highway bridges. Post-conflict is a policy focus for Japanese aid and Japan is interested in discussing the post-conflict province of Bougainville with Australia.

### *European Union aid to PNG*

The European Union (EU) is the third largest donor to PNG. The focus of EU aid efforts are in education, training and human resource development, rural water supply and sanitation, and institutional capacity building and governance. EU Official Development Assistance to PNG is delivered through its Country Strategy and National Indicative Program (NIP) 2002–2007. Potential areas for cooperation with Australia include the areas of education, HIV/AIDS, transport and coordination to build capacity of local NGOs, and use other non-state actors to deliver essential services.

## **Chapter 2: Emerging and critical issues**

### **Positioning the aid program in the broader Australia-PNG bilateral relationship**

The objective of Australia's aid program is 'to advance Australia's national interest by helping developing countries reduce poverty and achieve sustainable development.'<sup>22</sup> The purpose of this report is to consider how the aid program to PNG might be positioned over the next five to ten years to give stronger effect to this objective in the light of past experience and likely developments. It does this by addressing the role of the aid program in supporting the key issues of economic growth, political governance and stability. To do so the report outlines how Australia's national interest is to be understood in the PNG context.

There is no specific formal enunciation of Australia's broader foreign policy goals for its relationship with PNG, but Australia's national interests have been well documented in

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<sup>22</sup> *Australian Aid: Investing in Growth, Stability and Prosperity*. Eleventh Ministerial Statement to Parliament on Australia's Development Cooperation Program (September 2002)



*Advancing the National Interest*<sup>23</sup> statement which observes that ‘among the island countries of the South Pacific, Australia’s strategic, economic and consular interests are greatest in PNG...PNG will look to Australia to help keep poverty and lawlessness in check. The onus for meeting these challenges will lie with independent PNG: Australia can—and will—play a supportive role. Australia will continue to encourage sustainable economic and political reform and the strengthening of basic services. The [Australian] Government supports close engagement between PNG and the International Monetary Fund and multilateral development banks. Australia will also help PNG to build affordable, capable and loyal security services and to strengthen its border security, including in the Torres Strait area. The statement also notes that ‘both countries will have to work hard and with goodwill if this unique and complex relationship is to continue to deepen and mature.’

The recent Australian Strategic Policy Institute (ASPI) report—*Strengthening Our Neighbour*<sup>24</sup>—observed that Australia’s national interest considerations range from geo-strategic concerns relating to Australia’s defence, to more immediate concerns with the possible impacts on Australia of transnational threats such as cross-border crime, international terrorism, disease pandemics, and people movement.

National interest considerations dictate that Australia has a significant stake in a policy of enlightened self-interest towards PNG that combines these specific concerns with wider humanitarian interests and a shared history as the ex-colonial administrator and the largest nation in the South Pacific region. In essence, Australia has a strong economic and strategic self-interest in supporting PNG to deal more effectively with the challenges it faces.

PNG is of significant commercial interest to Australia. Two-way trade is valued at about A\$2 billion annually, making it Australia’s twenty-second largest trading partner.<sup>25</sup> The mining sector has traditionally been a focus of Australian investment interest in the country, with most larger Australian based mining companies involved in a number of projects, including gold mining and oil/gas.

Consideration of Australia’s broader national interests would reasonably be expected to include seeing PNG develop as a stable and peaceful nation, with an economy generating real growth, and improving social and human development indicators pointing to an enhanced quality of life for Papua New Guineans across the country.

Historically the relationship between Australia and PNG has been strong in some areas, stemming particularly from our colonial and historic ties. The relationship has included strong business links, close defence cooperation, and particularly, close people-to-people links. But the relationship has become more fragile in recent times. With the passage of time, the strong people-to-people links that underpinned the relationship in subtle, but important, ways are fading. Over recent years aid has come to dominate and define the relationship.

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<sup>23</sup> Foreign Affairs and Trade White Paper: *Advancing the National Interest*, 12<sup>th</sup> February 2003.

<sup>24</sup> Australian Strategic Policy Institute: *Strengthening Our Neighbour—Australia and the future of Papua New Guinea*, December 2004.

<sup>25</sup> Australian Government, Department of Foreign Affairs and Trade - Papua New Guinea Country Brief (April 2005).

The aid relationship between Australia and PNG is enshrined in the *Treaty on Development Cooperation* (TDC) signed by the two nations in 2000.<sup>26</sup> The TDC, in turn is based on the Joint Declaration of Principles Guiding Relations between Australia and PNG signed on 9 December 1987. The ECP is based on a Joint Agreement on Enhanced Cooperation signed on 30 June 2004. The TDC provides for the large part of the aid program to be developed as jointly programmed aid. It establishes the framework for providing Australian aid to PNG, including how priorities are to be determined and performance assessed. It also establishes the framework within which Australia is to determine the quantum of aid to PNG in a given year.

Notwithstanding regular high-level consultations between Australia and PNG at both official and ministerial levels, the generally weakening links between the two countries and the changes in the priorities and perspectives of both countries, associated with weak or inconsistent observance of some of the key provisions of the Treaty, have given rise to uncertainty and confusion about the aid program and, to some extent, increasing frustration and dissatisfaction on both sides. The 2004 Joint Aid Review<sup>27</sup> made recommendations on strengthening effective engagement between the two countries in relation to the aid program.

The events of the past 12 months or so, particularly associated with the ECP, make reconsidering key aspects of the aid program to PNG timely. Recent initiatives by the Australian Government make clear its concerns that PNG is not making reasonable progress in a number of areas, while for its part the PNG Government has voiced concerns that Australia is adopting an increasingly unilateral approach in its dealings with the country. These developments raise important questions about the relationship between the two countries and the future direction of the aid program.

What is needed now is not just another aid review. Clear directions, priorities and modalities for the aid program going forward need to be established which reflect the interests, objectives and aspirations of both countries, and to which both are committed. It is significant that the majority of Papua New Guineans, particularly those in rural and remote locations, strongly support the Australian aid program and, more generally, calls for change are neither dramatic nor widespread. (It is also significant that some senior PNG leaders are now articulating the need for a different aid relationship with Australia, including a path away from aid dependency). So far as the aid program is concerned, the over-riding requirement is to establish and implement cooperative processes to allow jointly agreed objectives and priorities to be determined, performance expectations to be set and monitored, and ways to work consistently, cooperatively and effectively to be consolidated.

For Australia's part, realistic expectations are needed. PNG is still a young country with limited resources, fledgling institutions and fragile governance. Its capacity to determine the directions it wishes to take, and to implement the policies and programs needed for sustained growth, is limited. Australia's aid, while a significant boost to available resources, is still only about 17 per cent of the budget envelope (excluding ECP).

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<sup>26</sup> The current TDC replaces an earlier TDC signed on 24 May 1989. . The earlier TDC facilitated the evolution of the development cooperation program from a budget support basis to a jointly programmed aid basis over a ten-year period.

<sup>27</sup> Joint Review of the Australian Aid Program to Papua New Guinea, Final Report, 31 August 2004.

Achieving improvements in areas of economic growth, service delivery and in improved governance will take time. Critically, it will require a consistent and constructive relationship with Australia in which the aid program will play an important part.

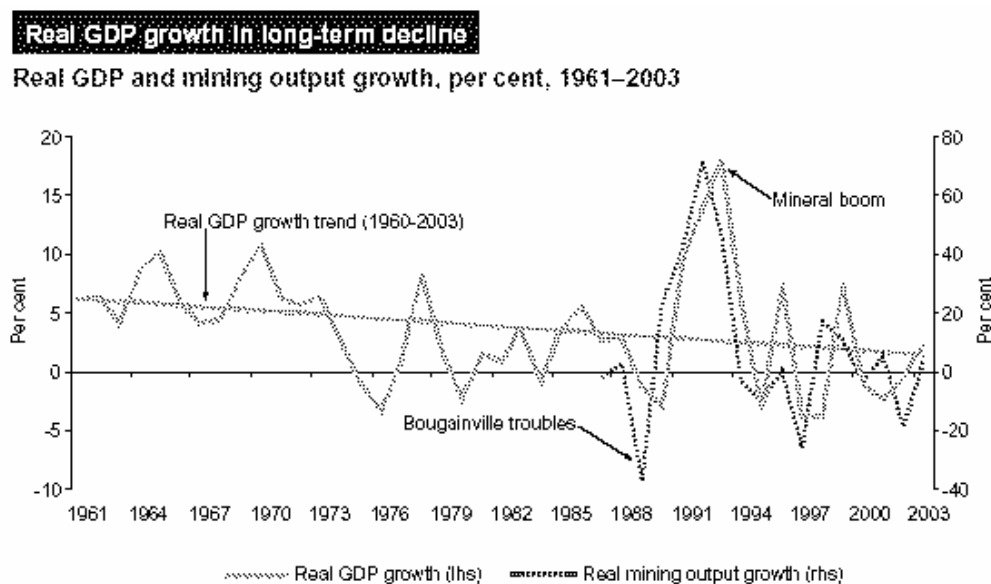
For PNG's part, stronger performance has to be achieved. Poverty is increasing, service delivery networks are failing and opportunities have been lost. The development of a sound and affordable policy framework is required, supported by a stronger and consistent commitment to growth, better governance and effective and equitable service delivery to people across the country. A consistent long-term approach is needed, with PNG's Government working in concert with development partners to implement a coherent and affordable agenda.

## Growth

### *Recent growth performance*

The last ten years have seen rising poverty in PNG, with estimates suggesting that 2.3 million Papua New Guineans are now living on less than US\$1 per day, up from 1.1 million in 1996.<sup>28</sup> The country's growth record over the last 20 years has been well documented. While growth year-to-year has been volatile (Figure 1) trend growth slowed from around six per cent per annum in 1960 to around two per cent in 2002.<sup>29</sup> From 1991 to 1994 the economy grew rapidly, largely due to the performance of the petroleum and mining sectors. Between 1995 and 2002 the economy contracted in all but two years. High inflation and rapid population growth mean that per capita incomes fell an estimated 18 per cent between 1994 and 2002. In US\$ terms per capita income in 2003, at US\$510, was substantially less than it was in 1975 (US\$560).<sup>30</sup>

Figure 1: Papua New Guinea—long-term growth performance<sup>31</sup>



<sup>28</sup> World Bank, Papua New Guinea: Interim Strategy Note, 2005.

<sup>29</sup> DFAT Economic Analytical Unit (EAU), *Papua New Guinea—The Road Ahead*, ( ), Figure 1.1, (Australian Government, 2004)

<sup>30</sup> World Bank, *op cit*.

<sup>31</sup> DFAT EAU report, *op cit* – Figure 1.1

PNG's economic growth performance compares unfavourably with other developing and emerging market economies. For example, in the Pacific region, real per capita GDP increased in Samoa more than 50 per cent over the same period, while growth in Fiji was some 30 per cent.

### *The social and human development dimension*

Despite improvements since Independence in some key social indicators,<sup>32</sup> overall PNG has the worst social indicators in the Pacific.<sup>33</sup> It has lower average life expectancy, a higher infant mortality rate and lower rates of adult literacy than most countries in the region. Women are particularly disadvantaged with lower life expectancy, significantly lower participation in the education system and high rates of maternal mortality. PNG is ranked 132 out of 175 countries by the 2003 United Nations Human Development Report Human Development Index and has the highest poverty index among the 12 Pacific countries.<sup>34</sup> PNG has remained in the bottom 25 per cent on the Human Development Index ranking over the past 25 years.

On the basis of its economic and social indicators, as well as indicators of institutional quality, PNG has been included by the World Bank as a non-core member of 26 countries categorised as low income country under stress (LICUS), also commonly referred to as fragile states. Other core LICUS countries (15 in total) include East Timor, Lao PDR, Cambodia, and Nigeria.<sup>35</sup>

PNG has a young population and one of the highest rates of population growth in the Pacific region. Its population has almost doubled, from 2.9 million at Independence, to 5.5 million (2003), growing at an average rate of around 2.7 per cent per year. Forty one per cent of the population is under the age of 15. The country's rapidly growing population is adding significantly to the burden of delivering essential social services. On current trends, the population is projected to double again over the next 20 years, by which time it will be approaching half the total population of Australia. However, depending on how it develops, the emerging HIV/AIDS epidemic in PNG could have a substantial impact on population growth over this period.

### *The village majority*

Eighty five per cent of the PNG population live in rural areas. The rural population grows almost all its own food and uses money from the sale of cash crops to meet some proportion of education and health care costs. This constitutes an important source of stability to the nation and a form of employment to a large number of the work force, including, importantly, young men.

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<sup>32</sup> AusAID (2003) 'The Contribution of Australian Aid to Papua New Guinea's Development 1975-2000', p ix

<sup>33</sup> World Bank, *op cit.*

<sup>34</sup> WorldBank: [www.worldbank.org/INTPAPUANEWGUINEA/Resources/II-Country-Context-Development-Trends.pdf](http://www.worldbank.org/INTPAPUANEWGUINEA/Resources/II-Country-Context-Development-Trends.pdf)

<sup>35</sup> *Evaluation of World Bank Support to LICUS – An Approach Paper*, World Bank (2005).- Table 1. . For FY05 26 countries are defined as LICUS – 11 of them are categorised as "severe" LICUS and the remaining 15 countries are categorised as core LICUS

It is important to the overall stability of PNG to recognise the on-going importance of village agriculture, and to ensure that the aid program does not undermine its role by inflating expectations which are illusory. It is clear that, even on the most favourable assumptions about growth, village agriculture will continue to sustain the overwhelming majority of Papua New Guineans for the foreseeable future.

Supporting the development and maintenance of infrastructure to support access to markets and to essential services is an area in which the aid program can contribute to strengthening village agriculture. Beyond that, Australian support in the areas of research and building up technical skills would be appropriate, and the contribution of village agriculture would be strengthened with improved governance and security generally. Consistent and equitable access to basic education and health services will also contribute to improving the quality of life in rural areas and enhancing the attractiveness of village life.

### *Prospects for growth*

Projections of future growth rates vary, as do views about PNG's growth prospects generally. The PNG departments of Treasury and National Planning have differing projections for growth, ranging from 2.5 to 5 per cent per annum over the next few years. With population currently growing by around 2.7 per cent per annum, even growth at the higher end of this range will not generate meaningful increases in real per capita incomes, let alone redress the loss of income over the 1990s. Even at the upper end, the growth forecasts are well below the six to seven per cent per annum which the IMF and World Bank consider necessary to make significant inroads into reducing poverty.

Spikes in growth have been due largely to the oil and mining sector. But in the extractive resource sector many projects are phasing out. Although there are some prospects from new projects, such as the gas pipeline to Australia, the medium-term trend for the extractive sector is not promising. The 2005 PNG National Budget projects that the contribution to real GDP growth from mining and oil over the next few years will vary from -0.9 per cent in 2006 to +0.6 per cent in 2009. In net terms the contribution of this important sector to real GDP growth is projected to diminish between 2005 and 2009. Beyond that time frame, the gas project, in particular, could contribute to offset this trend.

It is difficult to be optimistic, or even confident, about the level of growth that might be achieved over the next five to ten years, particularly the prospects for more broadly-based growth.

Some commentators have argued there is no natural resource constraint to sustainable real growth of around six to seven per cent per annum. They point to PNG's abundant fertile soils in which a wide variety of marketable crops can be grown, the considerable scope for agricultural productivity gains (which include a large land mass, huge factor endowments particularly in forestry asset, mineral deposits, and tuna stocks), and a large population base.

The 2005 National Budget projects around half of total GDP growth will come from the agricultural, forestry and fisheries sector between 2005–2009. While it provides the most substantial contribution to PNG's GDP and economic growth, the contribution of this sector will need to be substantially increased if higher overall levels of growth are to be

achieved. Given the lack of growth in the economy overall over the past two decades, the very small increase in the GDP share of this sector is of concern.

The Government's MTDS 2005–2010 recognises the importance of targeting rural development as a key to achieving higher levels of economic growth and poverty reduction. However, clearly defined strategies for growth, backed by the consistent implementation of priorities to generate it, are required if this potential is to be fulfilled. The lack of strong and consistent linkages between the last MTDS and the annual budgets undermined the effectiveness of the MTDS process. At this time, and notwithstanding the emphasis given to growth in the MTDS, specific strategies, assurance of funding and commitment to implementation are inadequately developed.

It is significant that PNG's own budget projections<sup>36</sup> show that central government revenue and grants as a percentage of GDP will peak in 2005 and then decline to 2009. While recurrent spending is also projected to decline to 2009 (17.6 per cent compared with 19.9 per cent in 2005), the proportion of recurrent expenditure accounted for by interest on debt and wages, at 64 per cent of the total (projection for 2009), is significantly greater than in 2002 (59 per cent). Other budget analysis<sup>37</sup> suggests that spending adjustments of up to 1.9 per cent of GDP will be needed over this period to keep deficits manageable. Warner finds that if expenditure constraints fall on spending on goods and services, rather than wages, real operations and maintenance will have to fall by 45 per cent over 2004 levels.<sup>38</sup> The clear implication of these projections is that PNG's capacity to improve standards of service delivery across the country over the next five years is expected to decline, rather than strengthen. The importance of stronger, broad-based growth which enhances the Government's fiscal capacity is clear.

### *Constraints to growth*

If PNG is to achieve the growth rate of six to seven per cent per annum over the medium term needed to redress the loss in per capita income since Independence, growth will need to be broad-based and sustainable. Generating sustained broad-based growth cannot be achieved without a focus on overcoming the constraints which currently hinder wider growth opportunities.

Commentators have drawn attention to a range of constraints to growth in the current PNG environment.<sup>39</sup> These have included:

- law and order issues
- infrastructure weaknesses which isolate people and their produce from markets
- corruption
- policy uncertainty
- investment and regulatory weaknesses and a poor governance environment for business
- inadequate human capital (skills, education levels, worker productivity, and health issues)

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<sup>36</sup> PNG 2005 Budget Papers, Volume 1 *Economic and Development Indicators*.

<sup>37</sup> Warner, Bob: in *Pursuing Broad Based Growth in Papua New Guinea*, non-published paper for AusAID, May 2005.

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.*

- poor social capital—a weak sense of national identity and national interest
- lack of financial market depth and poor access to funds for investment purposes (although there is evidence that it is the lack of productive opportunities rather than a shortage of capital that is the real constraint)
- constitutional impediments associated with the Organic Law on Provincial and Local Level Government
- property rights, including land tenure issues
- fragmentation
- lack of competitiveness.

To put these issues in perspective, the Department of Foreign Affairs and Trade EAU Report (see references) notes that PNG ranks poorly under the 2002 World Bank Governance Indicators Index. In terms of political stability, rule of law, government effectiveness, and control of corruption, PNG ranked below all other groups of countries, including Latin America, East Asia and sub-Saharan Africa.

These constraints to growth clearly need to be tackled aggressively if PNG is to achieve adequate rates of broad-based growth. But not everything can be achieved at once. Capacity constraints and absorptive capacity issues limit what can be realistically achieved. It is easy to overwhelm weak systems. Attention needs to be given to dealing with key or binding constraints, with reforms focused where their direct effects can be reasonably expected to generate the most significant benefits.

For PNG, binding constraints appear to be fundamentally related to issues of policy settings, identification of key priorities, consistent implementation of relevant and affordable programs, and governance. These include:

- getting the key economic policy settings and priorities right—and consistent adherence to an affordable and coherent agenda
- addressing infrastructure weaknesses, particularly roads, with an affordable and prioritised program for infrastructure development
- removing impediments and disincentives to investment
- addressing law and order issues (particularly for small businesses) and establishing an acceptable security environment for broad-based growth
- establishing a supportive framework for business through secure property rights, less burdensome and more streamlined regulation and improved governance standards which provide protection to business interests
- addressing corruption.

Responding to these constraints with a robust and effective reform agenda constitutes a daunting challenge for PNG, and for the aid program. But this is fundamentally where the program needs to be positioned. A key role for the aid program is to support identifying the key priorities that need to be addressed first, and, in concert with government and other donors, to support the effective and consistent implementation of initiatives to address them.

Setting out the detailed steps by which this could be achieved is beyond the scope of this report. One practical way to progress this is to establish a technical economic team, with representation from Australia and PNG, and possibly other parties, such as academic economists familiar with PNG issues, the World Bank and ADB—with a mandate to

identify and prioritise the key constraints to growth and to recommend a sequenced program to address these constraints, consistent with affordability. The results of this work would constitute an important agenda for the annual aid High Level Consultations and Ministerial Forum, with a commitment on both sides to reach an agreed implementation agenda.

## Positioning the aid program to support stronger growth

### *Infrastructure*

While there is no single view within the Government of PNG about what focus the aid program should have in fostering and sustaining economic growth, supporting the development of infrastructure (particularly roads, but also communications, airports and sea ports), is consistently stressed as the key priority.<sup>40</sup> Other priorities expressed include maintenance of important existing road assets and new roads (especially where these would assist market access). In addition to the direct growth benefits of roads—linking people, products and markets—the strong spin-off benefits to other sectors such as law and order, and health and education, are emphasised. As the PNG Treasurer observed, once there are roads, issues such as rural unemployment begin to take care of themselves.

In most parts of the country road maintenance, particularly funded by provincial governments, is almost non-existent. And it is not clear that inter-governmental funding arrangements provide an adequate guarantee that roads are being maintained in line with overall resource availability and the importance attached to this sector.

While the importance of roads is agreed, just how this priority should be pursued, and how donors can best work with the PNG Government is not clear. One senior official indicated that ‘PNG is not building any new roads under the MTDS, just maintaining the ones that link areas of high return.’ Key infrastructure expenditure programs in the transport sector referred to in the MTDS include the:

- District Roads Improvement Program (DRIP)
- Highlands Highway Rehabilitation Project
- Community Water Transport Project
- Airport Maintenance Project.

A current AusAID funded study—the Transport Infrastructure Priorities Study (TIPS)—is formulated against the prevailing circumstances of severe deterioration of much of PNG’s major transport infrastructure and highly constrained PNG Government public expenditure capacity. Accordingly, the TIPS is designed to assist PNG, AusAID, and other donors with robust identification of the physical infrastructure assets across the whole transport sector, which are vital to PNG’s economic growth. The TIPS is intended to establish the parts of assets that warrant top priority attention for restoration, rehabilitation and maintenance.

Although substantial, the aid funding provided to PNG by Australia (and other donors) can only supplement the funding requirements for major infrastructure works such as

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<sup>40</sup> Rehabilitation and maintenance of transport infrastructure is identified in the MTDS as a top expenditure priority for 2005–2010. . The 2005 PNG National Budget shows 26.6 per cent of the Development Budget (of which more than 80 per cent is provided through donor grants) is provided to the infrastructure sector already.



roads. PNG's commitment to the importance of roads, or any other sector, must be reflected in the allocation of its own domestic resources if progress is to be made.

### *Targeted interventions*

The current MTDS identifies the following sectoral expenditure priorities for 2005–2010:

- rehabilitation and maintenance of transport infrastructure
- promotion of income earning opportunities
- basic education
- development-oriented informal adult education
- primary health care
- HIV/AIDS prevention
- law and justice.

The PNG Government has emphasised the importance of impact projects as a means of accelerating growth. Many such projects are referred to in the MTDS—for example, against the priority of promoting income earning opportunities and supporting the development of industrial parks in key economic regions.

An issue for the aid program is how to respond to this emphasis. There is some call within PNG for the aid program to support the impact projects initiative as a priority, by supporting targeted interventions in particular industries, sectors or activities (mainly in agriculture). It was suggested, for example, that the aid program could support agriculture through dissemination of information technology (for example, farmers groups and industry organisations), improve agricultural material (for example, livestock breeds), and support feasibility studies of possible impact projects.

While there are some areas where such interventions could be consistent with Australia's comparative advantage and expertise, in the current environment of poor infrastructure, weak governance and policy settings, and inconsistent implementation of initiatives, their priority and effectiveness needs to be carefully assessed. A clear focus on growth and strengthening the enabling environment for it, through well targeted infrastructure support and improved governance, appears to offer far more. The appropriateness and priority that might be attached to such interventions could be usefully included in the work of the technical economic team recommended later in this report. The contribution of specific interventions to sustaining and strengthening village agriculture is needs to be addressed.

### *Institutions and capacity building*

While some observers of development have argued that economic growth should be the single focus for aid (most commonly through support for agriculture), the more widely accepted view is that institutions and governance matter. Indeed, there is compelling evidence that poor governance and weak institutions constitute a major impediment to growth. As a senior PNG Minister has indicated: 'There is potential for growth in both forestry and fisheries in PNG, but the governance issues are difficult. In these sectors PNG needs governance not capital; capital is needed in infrastructure and social services.'

It is difficult to argue against the focus of the aid program on building the capacity of Government to deliver core public sector functions as a necessary prerequisite for

sustained growth. This focus includes rebuilding the integrity and capabilities of the public expenditure management system and strengthening the central machinery of government.

## Political governance

### *The PNG context*

Like many post-colonial states, PNG's inherited system of governance structures, both political and bureaucratic, has shifted significantly. This shift reflects the fact that the framework of seemingly strong formal institutions was often inconsistent with pre-existing social forms, in particular networks of kinship and community which pervade the formal state at almost every level. In many parts of the country, local forms of social control are stronger than the order imposed by the state.

The political culture that has developed in PNG does not necessarily fit comfortably with the imposed Westminster system. It is a political culture that militates against the execution of institutional responsibilities under Western concepts by Ministers of Parliament (MPs). Instead, MPs elected by a kinship and community base that in most cases represents less than 20 per cent of their electorate, are expected primarily to provide returns to that constituency, once elected.

There have been attempts at reforming the political system, such as through changes to rules governing the electoral and party systems introduced in 2001 and the more recent introduction of limited preferential voting. These reforms have been plagued by weaknesses in implementation, and their impact remains to be tested.

Beyond issues of culture and behaviour are important structural questions, particularly about the functions, responsibilities and relationships of the three tiers of Government. Under the Organic Law on Provincial and Local Level Government, responsibility for a number of important service delivery functions rest with the provinces. The confusion and uncertainty about responsibilities, and the clear evidence that equitable funding arrangements to support these decentralised responsibilities have not been developed or implemented, contributes to weak governance and deteriorating service delivery across the country. This is an issue for the aid program: the effectiveness of efforts to support service delivery is being undermined by the weaknesses of the Organic Law arrangements.

### *Positioning the aid program to support political governance*

For the aid program, the implications of an analysis of Melanesian political culture include:

- Appreciating that PNG is different to Australia. It is still a young nation and the integration of its fledgling formal institutions with pre-existing social forms is far from complete. This will be a long-term process and neither the process nor the end product will mirror Australia's way of handling matters.
- Acknowledging that much of what influences the operation of PNG legislatures and the bureaucracies that serve them is beyond the scope of institutional strengthening and capacity building. Governance interventions at the bureaucratic or technical levels, while necessary in terms of restoring knowledge, procedures and norms, will often be subordinated in practice by the demands of political culture. The impact of

interventions to strengthen governance will be gradual and long-term. Expectations should be realistic.

- Having realistic expectations about interventions, to address weaknesses in parliamentary functions such as oversight or lawmaking (for example Public Accounts Committee and the Ombudsman Commission). While there may be growing demand for these functions from the more organised urban segments of civil society in PNG, the emphasis on the technical aspects of parliamentary operation is often more important to donors than to local people.

That is not to say that weak standards of political governance are acceptable. The evidence from countries with good long-term growth achievements is that adherence to some core first-order principles is required if sustained broad-based growth is to be achieved. These principles include the rapid accumulation of capital, efficient resource allocation, technological progress, and sharing the benefits of growth. The common experience of countries that have successfully grown has been maintaining macroeconomic stability, moving towards integration with the world economy, providing investors with effective protection of property rights, and maintaining social cohesion, solidarity and political stability.

High standards of political governance are essential if these principles are to be implemented consistently and effectively.

PNG has many institutions designed to support effective governance. These include an Ombudsman Commission, a National Audit Office, the Public Accounts Committee of the Parliament, an independent judiciary, and non-government organisations—such as Transparency International—all of which focus on governance issues. The evidence, however, is that these are generally weak, particularly in that they are given little committed support or effective follow up.

In this environment it is tempting for donors to promote the setting up of further institutions as a means of advancing a stronger governance agenda. But, if anything, arguably PNG has too many institutions, working ineffectively. Governance priorities may be better framed in terms of making the most important institutions and processes work better. This would be consistent with the lessons learnt from LICUS experience to focus on fewer, more effective institutions and a realistic governance agenda. Affordability and right-sizing concerns also argue for limiting the number of institutions as a general principle.

A series of public sector reform blueprints for PNG over the last decade have argued the need to:

- aggregate and streamline government functions as far as possible
- focus on strengthening core central agencies and the machinery of government, including improving cabinet processes and coordinating between central departments and line agencies
- focus on restoring existing systems and avoid introducing more change and new systems.

There is a need to strengthen institutions and processes. It is important for the delivery of the aid program to work through PNG systems and processes, not to set up parallel ones. This will be challenging and will require patience and perseverance. As a specific

contribution to institutional strengthening, institution-to-institution links—such as Treasury and Finance twinning schemes—have a role to play. These links may be equally important from an Australian whole-of-government perspective in sustaining interest, awareness and involvement of Australian agencies.

That said, there may be instances where further institutions are needed. Restoring the capability of the former Institute of Public Administration to provide training of public servants could serve to strengthen technical, ethical and governance standards in the public sector.

Much of the aid program's budget management and public sector reform work of recent years necessarily has focussed on the supply side of governance, which emphasises building leadership and management capacity in key central agencies and provides technical support to reform. More recently, the aid program has begun to strengthen demand for improved governance through:

- increased support for churches and non-government organisations to deliver services and to pressure national, provincial and local governments for better service delivery
- support for the media sector, particularly rural radio, to improve access, content and voice
- support for fairer and more representative elections and political representation, including through support for the implementation of PNG's new limited preferential voting system and for voter education to build popular understanding and demand for political accountability
- strengthening oversight and accountability bodies like the Parliament, key Parliamentary Committees (especially the Public Accounts and HIV/AIDS committees), the National Audit Office, and the Ombudsman Commission, which provide avenues for public scrutiny of government functions.

There is growing interest in the role civil society groups and non-government organisations might play in countries such as PNG. Currently in PNG church agencies provide something like 40 per cent of school education and 45 per cent of health services across the country (although their reach and effectiveness is significantly determined by the availability of government funding). The key question is whether the aid program should be supporting such organisations to play a stronger role as alternative channels for service delivery and/or as agents to demand greater transparency, accountability and stronger performance from government. Some international evidence suggests it is unrealistic in fragile states to assume government systems can carry the burden of service delivery, and that the starting point should be to strengthen what works. The conclusion is there will be times when it will be necessary to bypass the state altogether.

Community and civil society groups argue that not enough aid is reaching the people of PNG. They say that working through government structures blocks aid getting to the people. A World Bank policy note argues that when '[f]aced with weak state capacity there is a compelling case for providing services through non-governmental providers'.<sup>41</sup> And community groups in PNG advocate that a much larger amount of aid should be delivered through NGOs and civil society organisations. This view is also widely held in

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<sup>41</sup> *Good Practice Note for Development Policy Lending: Development Policy Operations and Program Conditionality in Fragile States*. Page 18: World Bank. June 2005.

Australia and attracts considerable support, particularly in response to frustration with poor government performance in service delivery.

Support for a greater focus on community organisations as key service deliverers essentially reflects a lack of confidence in government processes and systems in PNG and a lack of confidence that these can be reformed and strengthened. It also challenges the central question of what the role of, and what the fundamental obligation of, government(s) should be.

The wider involvement of community organisations is appealing, but the implications and consequences of proceeding further in this direction in any significant way must be weighed carefully.

With the exception of the churches, these organisations are not large or well organised in PNG. Their reach is limited, both in geographic coverage of the country, and their sectoral involvement. Community organisations can undoubtedly provide effective service delivery in pockets, but none offer wide-reaching delivery networks. There is little reason to think that if given a much more demanding mandate, they would not suffer from same weaknesses as government systems, including weaknesses in governance.

One consideration is the governance implication of supporting community organisations to deliver key services to the exclusion of government processes, systems and networks. There is a broad international consensus that, at a minimum, it is the role of Government to ensure that merit or public goods and services are accessible to citizens. This may entail direct delivery of services or support to other agencies in conjunction with safety nets. More widespread use of NGOs in service delivery would weaken the pressure on government to perform—that is, the governance imperative would be taken away and would leave Australian aid at the sharp end of service delivery. It seems more logical to view these organisations as important and valuable partners—of government and donors—in a more effective service delivery network and to support them in areas (geographic and sectoral) where they demonstrate particular strengths, but not as alternative networks which might replace reliance on government systems. An appropriate challenge for the aid program is to consider how to support stronger cooperation between Government and non-government service delivery agencies, underlined by the responsibility of Government to ensure services are provided.

There also appear to be prospects for greater involvement of the private sector in delivering basic services. There is already some involvement, particularly by mining companies, in providing health and other community services in local areas. In locations where there are reasonably large private sector operations, they could be used more deliberately as implementing agencies in the same way there is some scope for community organisations to be involved. But again, the private sector does not offer a national network which would support consistent and equitable service delivery across the country.

Given the well documented failures of governance in PNG, it is notable that there is not stronger and more effective demand from community and civil society organisations for greater accountability and performance, particularly from urban citizens. While it is essential to generate more consistent demands for improved performance, and there is scope for the aid program to support initiatives in this area, the lack of this demand at

present is further indication that these organisations are relatively marginal in their capacity to influence the national agenda.

It is difficult to identify empowered constituencies which might effectively demand greater performance and accountability by government. There is some evidence from Africa of universities playing this role, but this is not clearly evident yet in PNG.

### ***The Organic Law on Provincial and Local Level Government and Decentralisation***

As an issue of political governance, the arrangements under the 1995 Organic Law on Provincial and Local Level Government need to be reviewed. One senior Minister has observed that ‘the political structure and makeup of PNG hasn’t been right since independence.’

Under the Organic Law, responsibility for national functions such as defence and economic management have been reserved to the National Government, while responsibility for many key areas of service delivery in such areas as health and education have been vested in the provinces. The Organic Law provides a funding arrangement, including provincial revenue-raising powers and formula-based transfers from the National Government to support this decentralised approach to service delivery.

Implementation of Organic Law provisions has been haphazard and inconsistent. Confusion remains over responsibility for many functions and funding arrangements have proven unaffordable and inequitable. The results have been large inequities between provinces because of differing provincial revenue bases (in particular associated with mining royalties), buck-passing between tiers of government encouraging a lack of transparency, avoidance of responsibility for performance, and a further deterioration—in some regions a complete collapse—in service delivery.

The aid program has developed a Sub-National Initiative (SNI) in response to the challenges created by Organic Law arrangements and supports the work of the National Economic and Fiscal Commission (NEFC) in reviewing the financial arrangements between the national and provincial governments. The SNI initiative builds on experience from sector-wide programs and recognises that the responsibilities for service delivery now rest with the provinces. It also acknowledges that improved service delivery outcomes require the strengthening of provincial government capacities, as well as those at the centre. The initiative has three objectives:

1. improve the National Government’s ability to support and supervise sub-national levels of government
2. support sub-national levels of government to meet their service delivery mandates
3. improve the impact of the aid program by increasing consultation with both levels of government and improving coordination between program sectors.

The SNI is to work together with PNG’s Provincial Performance Improvement Initiative (PPII), designed to strengthen the capacity of Provincial Administrations to carry out their responsibilities under the Organic Law more effectively.

There are important questions about whether the focus of SNI and NEFC work is consistent with the more recent direction of the National Government. The National Government’s sub-national focus now appears to be on districts rather than provinces. The indications are that the National Government is looking to ensure services are

delivered by setting up Districts Treasury offices and instituting District Service Improvement Programs (districts are not a level of government under the Organic Law. A district is the electorate for Open members of the National Parliament).

Other views indicate that the wider reform agenda under the revitalised National Monitoring Authority initiative is based on a whole-of-government approach which includes a strong focus on the machinery that gives advice to government at a provincial level. This initiative is aimed at strengthening sustainability and capacity at the provincial level.

The Organic Law vests provinces with responsibility for important areas of service delivery, such as important components of health, education, agricultural extension, and road maintenance. Therefore it is not clear how a greater focus of the National Government on districts aligns with the more effective delivery of these services. The immediate issue for the aid program is whether SNI and NEFC work is proceeding on the basis of shared objectives with the National Government.

But there is a fundamental longer term issue—which type of decentralised structure will best support stronger performance in PNG? This is a relevant issue in the thinking about the positioning of the aid program over the medium term.

The World Bank has advocated decentralisation as a means of improving accountability for local service delivery but has noted that the modalities need to reflect the circumstances of the country. The evidence in PNG, where decentralised arrangements are contributing to worsening service delivery, is that the 1995 Organic Law model is flawed. To illustrate: in 2003, it is estimated the provinces spent K40 million on politicians, and K5 million on rural health services.

This is not just an issue of political governance. It is a critical consideration in stability and cohesion, service delivery and opportunities for growth.

## Stability

PNG is a young country and the nation-state is still forming from a fragmented base of more than 800 ethnic and language groups, many of which have long histories of conflict and competition with one another. Much of the country remains geographically isolated and inaccessible and communications infrastructure is limited. Internal stability remains a concern. The Highlands region, in particular, is unstable and afflicted by regular tribal fighting and lawlessness linked to political competition over access to resources. The secessionist movement and conflict in Bougainville resulted in autonomous arrangements (and likely eventual independence) for that province, which are generating autonomy demands from other provinces.

Internal violent conflict in places such as the Southern Highlands, fuelled by political competition and the spread of guns, also threatens stability and key resource assets. Natural disasters such as the Tsunami, volcanic eruptions and drought continue as ongoing threats, and the capacity to prevent and mitigate their effects, and deal with their consequences, remains weak.

Strengthening the cohesion of the nation will rely on consolidating the legitimacy, relevance and authority of the National Government. While this institution of parliament

provides the symbol of national government authority, the reality is increasingly very different.

At the most fundamental level, the relevance of the National Government to the people of PNG depends on the evidence of the Government as an active and relevant contributor to their well being, through delivery of basic services such as health, education, law and order, and infrastructure. At this level, there are profound weaknesses: service delivery from both national and provincial governments has deteriorated to the point where, in many parts of the country, there is virtually no day-to-day connection between people and government. The implications of this for stability are real.

In part this is associated with PNG's lack of growth since independence, and the resultant limited fiscal capacity of government to meet the needs of a rapidly growing population. But it is clear that policy settings, government priorities, and governance weaknesses exacerbate this situation. The constitutional structure of government is a further barrier.

Stability is, of course, inter-related with growth and governance. One view is that the district focus would provide the most effective way of reconnecting the people at village level with the National Government (the actual word used was to strengthen 'control'). The increasing irrelevance of the National Government to the lives of people across the country is, of course, an extreme concern. The response needs to be very carefully designed.

Political governance and political stability are not interchangeable. The current National Government appears likely to run its full five-year term in office. If so, this will be the first time since Independence that an elected government has completed a full parliamentary term. That is an achievement, but it would be premature to claim it as evidence of greater political stability. There has been substantial instability in the composition of Government and the National Executive Council over the period. More importantly, the longevity of the National Government has been accompanied by on-going weak governance, deteriorating service delivery and weak growth.

Secessionist pressures, or at least pressures to change the nature of the political relationship between some regions of the country and the nation as a whole, continue to manifest themselves from time-to-time. Some are the result of the settlement reached establishing the Autonomous Government of Bougainville. Others reflect a strong regional, local or clan desire to maintain control over resources, particularly the royalty flows associated with large mining developments. At present some of these demands, such as the greater autonomy claims from East New Britain, are being progressed through peaceful and democratic processes, while others, particularly in the Southern Highlands, have generated violence and conflict.

### ***Positioning the aid program to support stability***

Australian assistance has played a key role in bringing peace to Bougainville, in promoting stability and building confidence in the peace process and post-conflict recovery. Australian aid has had a high profile in supporting the establishment of the Autonomous Government in Bougainville, and this remains a priority of the aid program.



The program has also supported conflict prevention measures in the volatile but economically important Southern Highlands province. These included substantial financial support for enhanced security in the 2003 supplementary elections and support for conflict resolution work by local NGOs, churches and relevant national departments, to minimise the impact of poor governance and instability. Specific support through the aid program for the maintenance of order in the Southern Highlands has not been as obvious as has been the case for Bougainville.

While there will be opportunities for interventions to promote peace and stability, the most effective on-going response of the aid program to issues of instability is to support stronger broad-based growth, improved service delivery and more effective governance—that is, to strengthen the capacity of the state to meet the needs and aspirations of its people. In this sense, failure to lift performance in these areas will inevitably generate further instability and contribute to a further downward spiral.

## **Implementation of the program**

While the aid program has supported positive outcomes, particularly in consolidating the peace process in Bougainville, it cannot be said that since Independence, PNG's overall progress and achievements have been consistent with expectations—nor do they reflect satisfactory outcomes in overarching program objectives.

This is not to say that the program has failed or that its objectives are inappropriate. There are limits to what an aid program can achieve. But notwithstanding the level and direction of aid support, PNG's performance has continued to be weak in growth, service delivery and governance. By many measures, its performance is deteriorating.

The fundamental questions confronting the aid program over the next five to ten years are why PNG's economic and social progress has been so disappointing, why governance remains so weak, and whether Australian aid can provide more effective support for stronger outcomes.

### ***The size and reach of the program***

The Australian aid program to PNG is substantial in absolute size, although in per capita terms it is not as large as aid programs to many Pacific countries. Nevertheless, the program dominates total aid flows to PNG—about 80 per cent of all aid to the country is from Australia. The program reaches widely across many areas of activity in PNG, from remote, small-scale community social sector projects, to rehabilitation of the Highlands Highway, through to working with Government on economic policy and governance reform. In some sectors, the program provides virtually the only funding for goods and services reaching people in outlying regions of the country.

Providing substantial aid over a long period has contributed to generating expectations within Australia that better outcomes should have been achieved. The most instinctive response is that the program has failed.

The program has certainly failed to generate the kind of progress expected, but a more balanced conclusion may be that expectations have been overly simplistic and unrealistic. Put simply, in the PNG environment since Independence, and more particularly in the last ten to 15 years, there are real limitations to what could have been achieved. While it is not possible to observe the counterfactual scenario of how PNG would have fared in

the absence of aid over this period, it is most unlikely that performance would have been stronger without aid.

Arguably, the breadth of the program, with its reach into nearly all sectors of activity, has undermined rather than underpinned improvement in some respects. In some sectors, and some parts of the country, the availability of aid intervention has encouraged the substitution of aid for the use of PNG's own resources, allowing the latter to be diverted to other, often lower priority, uses. The availability of aid funding for pharmaceuticals, textbooks and road maintenance are examples of aid interventions which have facilitated substitution of donor resources for government support. Since aid funding was never going to be adequate to sustain effective service delivery programs across the country, this substitution has been associated with ongoing inadequate performance.

The Development Assistance Committee (DAC) of the OECD has observed that some level of aid dependency would certainly hurt the real economy. In the case of PNG, it would be drawing too long a bow to claim that this was the case with the Australian aid program, but it is certainly the case that the program has not worked well enough with PNG's own resources, with common priorities and in support of common objectives, and has thus failed to generate the more positive outcomes that should have been possible.

The World Bank and the ADB have suggested that the size and reach of the Australian aid program has also had implications for the involvement of other major donors. The banks have indicated that the size, role and pervasive presence of Australia's aid program, and the differing objectives and operational and governance requirements, have made it more difficult for them to work in PNG. In essence, the banks have suggested that Australia's consistent delivery of a \$300-million-a-year aid program, effectively without enforcement of performance requirements, has weakened their capacity to insist on the Government meeting obligations, or other conditions for lending, and has thus squeezed them out. There are other issues for the banks, but these observations bear some consideration.

### ***Focus and positioning of the aid program***

The breadth of the aid program may also have contributed to a failure to leverage stronger overall performance by the PNG Government. The flexibility of the program (which, in part reflects its size), and a genuine and well-intentioned willingness to respond to emerging issues of need, has clearly generated expectations among some groups in PNG that the resources of the aid program are available if representations are made. This contributes to a sense that the program can, and will, pick up whatever needs are not catered for by PNG's own programs. In some cases, it appears that the aid program is seen as the preferred point of first call.

The 2004 Joint Review of the Australian Aid Program to PNG noted that: 'The capacity of the program to respond positively when particular issues arise does contribute to the impression that it is all things to all people.'<sup>42</sup> One of the more important implications flowing from this perception relates to the incentives for the PNG Government to accept responsibility for the roles it should reasonably be expected to assume. As the Joint Review observed: 'There is an argument that the program has stepped in to fund

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<sup>42</sup> Joint Aid Review, *op cit* page 33

particular activities for which the Government of PNG itself should have accepted responsibility'.<sup>43</sup>

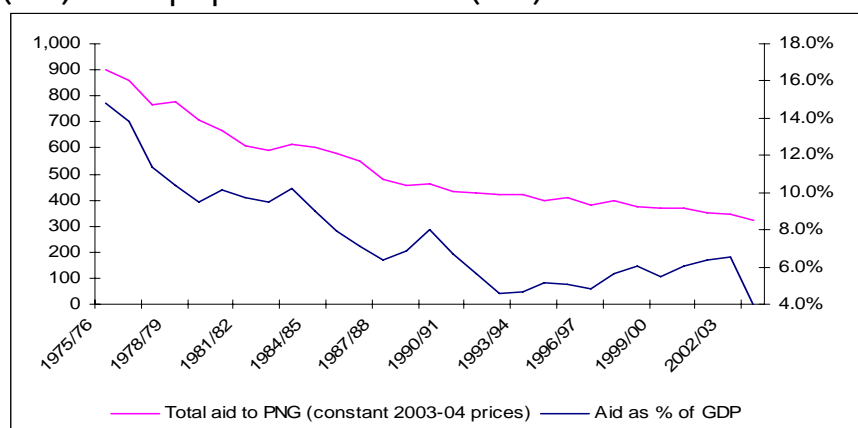
Australia is not responsible for service delivery, or particular outcomes in PNG. The only effective and sustainable contribution of the aid program is to complement and support the work of the PNG Government in meeting its responsibilities and objectives, not to supplant it. In the area of service delivery, arguably the aid program needs to force itself further away from the mindset that it must take responsibility for everything that goes on in PNG. This is particularly relevant given the continuing decline in the value of the aid program (excluding ECP) to PNG in real and relative (to GDP) terms as shown in Figure 2. For those working on the program's design and implementation, it may be difficult to accept there are areas of intervention for which the program has previously accepted at least some degree of responsibility that would no longer be continued. Of course, a stronger focus on growth and governance carries this same clear implication. The greater the focus on other matters, the less the program will be able to support involvement in a wide range of service delivery activities.

There must also be questions about how far the internal managerial and technical resources in AusAID can be stretched across a broad agenda without negative consequences for the impact of the program.

A clearer focus for the Australian aid program (and in this context clearer means narrower), coupled with firm governance arrangements, should facilitate the stronger involvement of other donors who may be better placed to deal with particular aspects of the challenges associated with promoting growth. For example, the World Bank may be able to make a stronger contribution to promoting private sector development, and the ADB in supporting infrastructure development.

A common observation of the many studies undertaken of the PNG Government's public expenditure management is the need for stronger, more effective and more consistent performance. In essence, the evidence over the last 15 years or so is that fiscal policy has been weak and inconsistent, and that inadequate attention has been given to the quality of expenditure. An aid program cannot work effectively in an environment of weak fiscal policy, and certainly cannot substitute for it.

**Figure 2: Australian aid to Papua New Guinea 1975–2004 in real (A\$ millions) terms (LHS) and as proportion of PNG GDP (RHS)**



<sup>43</sup> *Ibid*

Going forward, an essential feature of the aid relationship must be that aid works effectively with PNG's own resources, in support of agreed objectives and priorities. A carefully constructed compact which sets out the role the aid program is to play in supporting PNG's own efforts—and the responsibilities which the Government will meet through its own efforts—would provide much needed clarity. Any compact would require performance benchmarks which should be realistic, achievable, and agreed with PNG through consultation—not imposed unilaterally. This would require revisiting the existing Treaty on Development Cooperation and strengthening some of its key provisions.

### *Emerging priorities from fragile states and other international experience*

The World Bank includes PNG in its grouping of fragile states (or LICUS). Whether this term should be applied to PNG, it is reasonable and appropriate to look at lessons learnt from experience with fragile states in thinking about the parameters within which the aid program might be positioned and progressed.

Recent research on fragile states has concluded that, without assistance, fragile states have little prospect of overcoming their problems and are likely to experience ongoing fragility and stagnation for generations.<sup>44</sup> The conclusion from these, and other studies, is that donors must invest in fragile states to avoid further deterioration, addressing aspects such as law and order, service delivery and improved public administration and political governance.

The United Kingdom's Department for International Development (DFID) has noted that because fragile states have difficulty absorbing large amounts of aid, there is a need to focus on areas where capacity is least weak and on removing barriers to the effective use of future support. Policy reform needs to be carefully planned so as not to overload fragile institutions.

This analysis has given rise to the concept of 'good enough' principles which has relevant messages for thinking about what might be appropriate in PNG and how an aid donor should proceed. These principles are to:

- encourage focus on the main causes of instability and main capacities of the state
- aim to achieve visible results in the short term (to build momentum for future reform); avoid the most politically or socially controversial issues (because these may weaken the momentum for reform)
- avoid reforms that are too ambitious
- ensure reform does not erode existing capacity
- strengthen accountability and the legitimacy of government.

The aid program needs to reflect these principles in its design, implementation and expectations. Arguably the program in the past has been too ambitious, too broad and has sought to progress too many objectives without regard to sequencing to support the most important priorities. These are important building blocks for an effective country strategy for the aid program.

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<sup>44</sup> Chauvet, L. and Collier, P (2005) 'Development Effectiveness in Fragile States: Spillovers and Turnarounds', *Paper prepared for DAC Learning and Advisory Process on Difficult Partnerships*.

### ***Central agencies and the machinery of government***

PNG cannot effectively address the challenges it faces without the effective functioning of the central machinery of government driving a coherent and affordable agenda. The effective performance by line agencies and provincial governments requires effectively functioning central agencies working cooperatively and consistently. The performance of central agencies will have an impact on PNG's ability to generate growth, its success in lifting standards of service delivery, improving governance, and in strengthening the cohesion of the nation. It is an essential prerequisite for aid effectiveness.

The design of the ECP recognised the importance of central agencies and the machinery of government. While the immediate outlook for ECP is unclear, the aid program must maintain its engagement with central agencies as an essential ingredient to improved performance.

### ***Ownership and affordability***

The PNG Government generally acknowledges that the aid program cannot solve the country's problems and that it has to take ownership of its own destiny and provide the vision and direction for achieving it. The aid program cannot work effectively in the absence of a coherent and prioritised agenda, developed by and within PNG, and to which there is strong ownership and commitment. 'Programs should be selective, focusing on a modest reform agenda where there is sufficiently strong national ownership.'<sup>45</sup> If these conditions exist, the aid program can have a real impact.

The importance of ownership needs to be recognised in the way Australia engages with PNG. While PNG may (or may not) accept a program developed against the perspectives and priorities of donors, it is unlikely to own it. Donors must find a way to engage with the country constructively and comprehensively over priorities and roles. And they must do it early.

The cooperative development of a program must also reflect affordability. PNG will have its own legitimate priorities which will not always be consistent with the priorities of donors. Affordability means that priorities are adequately resourced; this in turn means that not everything can be supported.

The aid program needs to be developed in a way that supports ownership and affordability.

### ***Compacts and performance management***

Today there is lack of clarity and wider lack of understanding in both Australia and PNG about what the aid program can achieve in PNG, and the environment required within the country to make it more effective. A well-structured mutual performance obligation framework would facilitate much greater transparency in the program, and would make much clearer to all concerned what the mutual expectations were, and how the commitments of all parties were to be progressed. In short, such a framework would clarify what each party had undertaken to do, and would provide a basis for monitoring and evaluating performance.

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<sup>45</sup> *Good Practice Note for Development Policy Lending: op cit* - page 10.

The application of compacts, or other performance measures to establish clearly how aid will work with PNG's own resources, and how the effectiveness of interventions can be assessed would strengthen the aid relationship. DFID has observed generally that well targeted sanctions may have some impact on the pace of reform, and the 2004 Joint Aid Review noted that the principle of mutual obligation has value for both governments. Conditionality can be helpful if it bolsters a government's case for implementing policy measures to which it is already committed and helps to operationalise its strategy.<sup>46</sup>

Applying performance benchmarks to the aid program is required under the provisions of the Development Cooperation Treaty, but this has not been consistently achieved. The scale and reach of the program in PNG makes this an important issue. Establishing compacts to guide and monitor performance was also a feature of the proposed JCS with the World Bank and the ADB. Recent discussions at officer level have highlighted resistance within PNG to the concept of broad-based performance measures, largely on the grounds that these impinge on sovereignty. A compact is not to undermine sovereignty, but rather to enhance it. Meeting the basic needs of citizens and responding to their aspirations is fundamental to sovereignty. A compact which strengthened performance in this direction, and which was developed cooperatively between the two governments, is consistent with sovereignty. A programmatic approach, with a sequence of operations, may be appropriate. 'A programmatic approach would signal commitment from Australia (and potentially other donors) as well as by the Government of PNG, offer some predictability in funding, and progress could be mapped out in small steps'.<sup>47</sup>

Sensible and well-constructed compacts, which included agreed requirements for monitoring and evaluation, would not only provide a benchmark for donors to monitor and assess performance, they would also support PNG's own efforts in areas where it acknowledges the need for improvement. Correctly determined and specified, there is nothing objectionable in the notion of a compact which establishes mutual obligations and performance expectations.

The essence of a compact is that institutions do what they are supposed to do. As such, it should be possible to embed compact principles as something within the PNG system which PNG values.

Compacts would apply at different levels. At the highest level a country-to-country/government-to-government compact would establish the framework within which development assistance would sit. Negotiated cooperatively, this would establish the commitment of the Australian Government to support PNG's development objectives through agreed interventions, and the PNG Government's commitment to accept responsibility for achieving progress in agreed areas and undertaking agreed functions and activities. At this level the language might be about shared aspirations and objectives. It might be about agreed processes and directions. The language would be looking for evidence of direction and commitment to policy and commitment to implementation, rather than specific milestones.

Such a compact would set out the expectations of both governments, and the circumstances of performance which might give rise to incentives (such as additional aid funding), or non-performance, under which sanctions (such as partial withholding or

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<sup>46</sup> *Ibid*, page 11.

<sup>47</sup> *Ibid*, page 8

reduction of the aid program) would be applied. It would be logical to assume that an overarching government-to-government compact, would espouse broad principles and values—such as ‘supporting stronger broad-based growth’, ‘eliminating corruption’, ‘improving transparency’, ‘improving standards of governance’, ‘strengthening law and order’, ‘improving service delivery’, and ‘reducing the size of the public sector’.

The principle underlying compacts would logically extend in more specific terms to government demanding that its parts perform—for example, central agencies (Central Agencies Coordinating Committee [CACC] and National Executive Council [NEC]) requiring performance from each other and from service delivery agencies. At this level, specific compacts could cover key sectors or programs with specific performance targets.

In negotiating a compact which would embrace the aid program overall, PNG’s weak capacity and weak management at all levels needs to be recognised. If the bar is set too high, any initiative will fail.

The concept of a compact requires the capacity to evaluate performance. The more specific and detailed the compact, the more precise the performance measures can be.

By way of illustration, a compact approach to strengthen performance management and position the aid program could include:

- Identification of sectoral priorities (for example, infrastructure and national roads that provide linkages to markets). These will reflect PNG Government priorities (for example, as set out in the MTDS) and the priorities of the aid program.
- Agreement on activities to be supported by the aid program and an indicative level of support as well as agreement on the level of support to come from PNG and activities to be undertaken by PNG.
- Assessment of the level of appropriation in the National (and provincial) Budget for functions to be undertaken by PNG. Are these consistent with the MTDS? Are they consistent with a level of commitment which warrants Australian support?
- Monitoring of budget implementation against appropriation—that is the actual expenditure (warrants) to be monitored.
- The agreed level of Australian support would be subject to PNG meeting its undertakings in actual expenditure performance against the agreed priority areas.
- The inclusion of AusAID in Quarterly Budget Reviews. This would enable informed monitoring of performance of the agreed compact.
- Following the Third Quarter Budget Review, issues relating to implementing the agreed compact performance would be examined by the Country Effectiveness Review (as recommended by the Joint Aid Review)—leading to agenda discussion at high level consultations on the annual Ministerial Forum.

Where progress is uneven, assessment should be based on an overall assessment of progress.<sup>48</sup> Other elements which could be incorporated in this approach could include:

- Australia assuming responsibility for specific sectors subject to the Government of PNG meeting agreed commitments in other areas.

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<sup>48</sup> *Ibid*, page 12

- Australian support reflecting overall macroeconomic management performance and policy directions.

The suggestion that AusAID be part of the budget review process should not be seen as interference in PNG's procedures. If the two governments are to work effectively together and, most critically, to leverage the strongest outcomes from the complementary use of resources, it is essential that both are fully and equally informed about fiscal conditions and progress in budget implementation. Similarly, the notion that Australia might assume responsibility for specific sectors is not to challenge PNG's sovereignty, but rather to maximise the positive impact of the resources available. Any move in this direction would be based on agreed roles, responsibilities and contributions.

### ***Modalities—delivery mechanisms***

A theme running through this report is the need for consistency. This also applies to aid modalities—the way aid interventions are designed and implemented. The 2004 Joint Aid Review noted that changes in priorities and efforts to improve aid effectiveness through new modalities have too often caused confusion and uncertainty. It observed that interventions need time and commitment to work. While this observation would most commonly be understood as a call for consistency in priorities and direction, those involved on the PNG side in the management of the aid program, argued equally forcefully for consistency in modalities.

Consistency does not mean there should be no change. For example, working more closely with recipient government systems and channelling aid through recipient government channels—such as in the case in the sector-wide approach in health in PNG—has, of necessity, required change. Changing delivery modalities can yield substantial gains in recipient ownership, efficiency, effectiveness, and sustainability of outcomes. However, to the extent possible, change should be evolutionary rather than revolutionary in nature. It should be carried out following full consultation with all parties, and continual change should be avoided. The reasons for and benefits of change may not be embraced as quickly within PNG as within Australia. And as mentioned above, the view from PNG is that consistency in delivery matters.

Debate over the most effective modalities for aid delivery continues. Over recent years there has been a shift by some bilateral donors, most particularly the United Kingdom, away from traditional project support and towards non-earmarked or untied general budget support. Multilateral agencies such as the World Bank and the ADB are redesigning their adjustment lending in similar ways, moving away from conditionality-driven support to more loosely targeted budget support in the form of Adjustable Program Loans. Aid evaluations in the 1980s and 1990s have pointed to a litany of problems with traditional off-budget projects.

More generally, within the DAC there is recognition of the need to understand the political incentives and the institutions that affect the prospects for reform, and a view that aid modalities work best when they are matched with appropriate circumstances, with budget support often favoured for good performers. However, there is no consensus that one modality is superior to others in all circumstances, and no evidence which would robustly support any such conclusion.



### ***Key strategic partners: Better harmonisation***

The benefits of donor coordination are obvious; achieving it is difficult, and the more it is talked up the harder it appears to be to succeed.

In 2002 Australia, the World Bank and the ADB sought to design a Joint Country Strategy with PNG (as discussed in Chapter 1). Notwithstanding the problems encountered with the JCS approach, better harmonisation among donors (and between donors collectively and PNG) is essential if full value is to be leveraged from donor support. Donors remain strongly committed to a joint approach in aid delivery. Even without a JCS the approach of donors to PNG working together has yielded some successes, notably:

- Improved coherence of policy dialogue and advice from donors, particularly through the complex negotiations which led to the cancellation of the Forestry and Conservation Loan (World Bank) and the Public Sector Loan (ADB).
- The development of a Public Expenditure Review and Rationalisation (PERR) which sets the basis for a range of initiatives by PNG and donors to tackle critical fiscal management and public sector reform issues.
- Joint analysis in key sectors such as health, education and transport, providing a common platform from which to build integrated assistance.

Further joint work is being undertaken in the infrastructure sector and in particular Australia, the World Bank and the ADB have agreed 'in principle' to a joint feasibility study of enhanced donor harmonisation within the PNG Transport sector which will be undertaken in the second half of 2005.

The World Bank and ADB can bring substantial intellectual resources and broad international experience to bear on policy issues in PNG, and AusAID may be able to leverage the Bank's engagement by offering to co-finance certain activities. Co-financing may prove effective in narrowing AusAID's direct focus, and gaining value-for-money and less intensive management in areas such as private sector development.

Australia has a long-term commitment to building relationships, engagement and frank dialogue with other donors to PNG. However, the benefits from a joint approach cannot be achieved unless PNG becomes fully engaged and supportive of donors working collaboratively together.

The different performance and governance requirements of the international financial institutions on the one hand, and Australia's bilateral program on the other, may make it difficult for donors to develop and operationalise a formal joint Country Strategy, irrespective of the position PNG might take. More informal harmonisation and cooperation may offer a better prospect.

If Australia is to work more effectively with other donors, a mature judgement is required about the country's comparative advantages as a donor. Australia's comparative advantage may include its strong functioning democracy, sharing similar institutional and accountability systems, public expenditure management in government, geographic proximity (trade and access to government services), being the largest donor by an order of magnitude, and being a regional leader and an advocate for the Pacific outside the region.

Australia also needs to recognise the governance arrangements which support or limit the activities of others, particularly the international financial institutions, and ensure that its own engagement with PNG does not crowd out others.

### ***Country Strategy***

The *Papua New Guinea Country Strategy 2000–2003* sets out four key objectives: strengthening governance; improving social indicators; promoting sustainable economic growth; and consolidating the peace process in Bougainville.

The 2004 Joint Aid Review emphasised the role and value of the Country Strategy. It noted that: ‘Given the scale and scope of the Australian aid program, an agreed country strategy is essential to ensure there is overall balance and coherence in the program itself, and to ensure there is consistency with the development priorities of the Government of Papua New Guinea.’<sup>49</sup> The review also recommended that the Country Strategy should be a more operational document than it has been in the past, and should establish for both sides what the aid program aims to achieve over the period of the strategy.

Australian officials have indicated that the guiding principles of the new strategy will be:

- consistent with LICUS/fragile states paradigm which underlines the importance of strengthening political governance, targeting corruption, building sustainable government institutions, exploiting opportunities to stimulate sustainable economic growth, and maintaining delivery of services to minimise the impact of system failures on the poor
- consistent with the development priorities articulated in the PNG Government’s MTDS 2005–2010
- informed by the findings of the August 2004 joint review of the Australian Aid Program—that is, a more operational document, guiding the implementation of the program.

Donor harmonisation issues will also feature strongly in the new Country Strategy. At present, the joint progression of a new country strategy by officials of both countries working together has been impacted by on-going negotiations over the immediate future of the ECP. The observations of the Joint Aid Review appear appropriate and should guide this work over the coming months.

## **Chapter 3. Conclusions and recommendations**

### **Directions for Australia’s aid engagement over the next five to ten years**

#### ***Implications for the aid program: Drawing these together***

This report draws three fundamental conclusions that should inform the future direction and positioning of the aid program in PNG over the medium term:

1. PNG must generate stronger economic growth
2. service delivery needs to be improved
3. governance must be strengthened.

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<sup>49</sup> Joint Aid Review, *op cit*, page 67

PNG must generate stronger economic growth. Growth at nearly double the rates currently projected in the budget for the coming years needs to be achieved if poverty is to be reduced. Growth needs to be broad-based to maximise the direct impact on the lives of people across the country and to strengthen the Government's fiscal capacity to contribute effectively to the economic and social advancement of people across the country. Carefully prioritised programs and consistency of implementation are required. Overcoming constraints to growth is the key. The aid program must support growth if the capacity of the PNG government to deliver improved services is to be strengthened.

Governments at all levels in PNG must improve service delivery. This requires a stronger fiscal position overall, greater equity in access to funding for service delivery, more effective operation of the decentralised service delivery framework, identification of priorities, and stronger and more consistent commitment.

Improving the enabling environment, strengthening governance and generating stronger growth are interdependent.

The stability and cohesion of the nation is at risk if these are not achieved.

The need to lift the availability of resources in PNG remains, and the reality that PNG faces huge challenges and costs in providing services cannot be ignored. However, more could be achieved with available resources. The inefficient, ineffective and inconsistent use of existing resources is frustrating better outcomes.

The aid program can be most effective if its focus is to support the PNG Government to overcome these weaknesses. Specifically, this suggests the program should focus on the following features.

### ***Supporting stronger broad-based growth***

A strong focus on addressing the binding constraints that have inhibited PNG's growth performance. Priorities should be:

- A stronger focus on infrastructure. This is consistent with PNG's own priorities as set down in the MTDS, but greater clarity is needed on the respective contributions of donors and PNG itself, including for infrastructure maintenance.
- Other binding constraints. A manageable and carefully prioritised program of initiatives is required to address constraints which impede growth and development—with full cooperation of all parties and within the limits of what can be achieved without overwhelming capacity. A joint technical economic team, with representatives from PNG, Australia and possibly other donors such as the World Bank, could be tasked to produce a critical path analysis, including prioritised and sequenced actions required to address critical constraints to growth, consistent with the objectives of the MTDS. Genuine partnership and PNG Government commitment to implement the outcomes of any such study would be essential.

In supporting growth, the aid program must work in concert with other donors and draw on the comparative advantage of different donors, particularly the development banks. Critically, it must work in concert with the PNG Government and its use of its own resources. Clear priorities and expectations need to be established, supported by consistent implementation.

***Supporting PNG's efforts to improve service delivery to the most vulnerable—  
with reduced exposure to, and involvement in, service delivery generally***

A stronger focus on supporting growth will require reduced and more focused support for service delivery. This implies that PNG must accept greater responsibility for service delivery generally. Priorities will need to be agreed upon and implementation monitored. Consistency and long-term support are required.

***Working strategically to improve governance***

Interventions should recognise and reflect the practical reality of good enough governance. This means identifying key priorities, and focusing on practical issues, particularly strengthening the machinery of government.

The arrangements and functional responsibilities under the 1995 Organic Law on Provincial and Local Level Government need to be re-examined. The decentralisation framework established under this law provides neither equity nor efficiency. It has contributed substantially to deterioration in service delivery, lack of transparency and accountability, and weak performance. The aid program can provide critical support, but there must first be clarity about the nature, extent and objectives of decentralisation.

Overall, there is a need for greater rigour in monitoring and evaluation aid effectiveness. This should be important to both governments. It is essential that Australia's aid efforts support PNG's own resources in delivering agreed priorities. A compact which sets out agreed priorities and mutual commitments and expectations of both governments would provide a framework for consulting, monitoring and evaluating. It is difficult to see how an aid program of the relative size and reach of the kind in PNG can be implemented with consistency and coherence without such a framework. A compact would be effective in ensuring the Country Strategy, when finalised, is appropriately operationalised.

The current aid program sits within the Treaty on Development Cooperation agreed between the two governments in 2000. Much has changed since then. Following the release of the White Paper it would be appropriate to review and, if necessary, renegotiate the Treaty. This report suggests that renegotiation is needed to position the aid program more effectively over the coming years.

Australia has consistently been clear that it will continue to play a long-term role as a partner in supporting PNG's development efforts. This is important. While PNG must generate stronger outcomes in the years ahead, this will be a long-term process, even under the most favourable circumstances.

Australia's long-term engagement must also come with consistency and patience. There are no quick fixes. Changing priorities undermines confidence and generates confusion. This in turn weakens prospects for positive outcomes. Unrealistic expectations similarly generate counter-productive frustrations.

Above all, engagement between the two countries, at all levels, needs to be consistent and constructive. Delivering a large aid program, which is critical in supporting and complementing PNG's own efforts, can only be effective if the spirit of mutual respect and cooperation is strong.

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## **Attachment II—Consultation list**

### **In Papua New Guinea (Port Moresby May–June 2005)**

#### **Meeting with Department of Prime Minister and National Executive Council**

Felecia Dobunaba

#### **Meeting with heads of agencies**

Crispin Conroy (DFAT—Deputy Head of Mission), Leisa James (AFP), Dougal McMillan (Defence)

#### **Meeting with Department of Planning**

Valentine Kambori and others

#### **Meeting with Program Support Unit (PSU)**

Judith Ugava-Taunao, Emmanuel Wrakuale, Sam Talepakali, Moale Vagikapi, Janet Philemon, and others

#### **Meeting with international financial institutions**

Benson Ateng (World Bank), Steven van der Tak (Asian Development Bank), Ebrima Faal (International Monetary Fund)

#### **Meeting with first secretaries**

Stuart Schaefer, Kristen Pratt, Mike Hunt, Romaine Kwesius, Danielle Hienecke, Hannah Birdsey, Debbie Reschke, Richard Slattery, and others.

#### **Meeting with PNG Treasury**

Honorable Bart Philemon (Ministry for Treasury and Finance), Honorable Sam Akoitai (Minister for Mining)

#### **Meeting with Department of Provincial and Local Government Affairs (DPLGA)**

Secretary Gei Ilagi, Deputy Secretary of Technical and Monitoring Division, Tau Vali

#### **Meeting with business community**

Greg Anderson, John Leahy, Maryanne McDonald, Winifred Kanit, David Conn

#### **Meeting with ECP Core Group**

#### **Meeting with Treasury**

Acting Deputy Secretary Ms Nino Seruva (and three colleagues)

#### **Meeting with Charles Lepanim**

#### **Meeting with AusAID project team leaders**

Barbara Smith, Maxine Whittaker, Jenny Clement, Michael Ward, John Petit, Boston Coleman, Jane Davy, John Jarvis

#### **Meeting with senior advisers to PNG Government agencies**

Rob Crittenden, Andrew McNee, Kathy Whimp, and Fiu Igara



**Meeting with Department Education**

Dr Joseph Pagalio (Acting Secretary), Deputy Secretary for Policy and Administration, First Assistant Secretary, Assistant Secretary

**Meeting with NGO—civil society representatives**

Sisa Kini, Wayne Golding, Lawrence Stevens, John Nonggorr, Peter Aitsi, Scolla Warai Kakas

**Meeting with Department of Health**

Dr Nicholas Mann (Secretary of Health)

**Meeting with university/academics**

Dr Thomas Webster (National Research Institute), Mike Manning (Institute of National Affairs), Dr David Kavanamur (UPNG)

**Meeting with Department of Community Development**

Dame Carol Kidu (Minister for Community Development)

**Discussions with Steve Hogg** (on secondment from AusAID with Department for International Development, London)

**In Australia (May–July 2005):**

**AusAID PNG Branch, Canberra**

**Meetings with senior officials from Australian Government departments and agencies, Canberra, including:**

- Prime Minister and Cabinet
- Treasury
- Attorney-General's
- Foreign Affairs and Trade
- Finance and Administration
- Australian Federal Police

**JTA International, Brisbane**

Jane Thomason

**Australia—Papua New Guinea Business Council, Brisbane**

**GRM International, Brisbane**

Wayne Read, Peter McColl

**Lowy Institute for International Policy, Sydney**

Malcolm Cook

**Asian Development Bank, Sydney**

Naomi Chakwin

**World Bank, Sydney**

Cyrus Talati

**Australian National University, Canberra (roundtable meeting with academics)**

Andrew McIntyre, Satish Chand, David Hegarty, Sinclair Dinnen, Bob Cotton, and others

## Attachment III—The evolution of Australia’s aid engagement with PNG and its drivers

### 1. *National interest considerations*

Australia has compelling strategic interests in a stable and prospering PNG. Australia shares a strong historical bond with its closest neighbour and its people. The economic, social and security interests of the two countries are linked.

The last ten years have seen rising poverty and instability in PNG, with 2.2 million Papua New Guineans now living on less than US\$1 per day, up from 1.1 million in 1996.<sup>50</sup> Despite substantial improvements since Independence in some key social indicators,<sup>51</sup> overall PNG now has by far the worst social indicators in the Pacific.<sup>52</sup> On the basis of its economic and social indicators, as well as indicators of institutional quality, PNG has been included by the World Bank as one of 26 countries categorised as LICUS— also known as fragile states. Other LICUS countries include the Solomon Islands, East Timor, Somalia, and Nigeria.

In recent years PNG has also seen positive developments, most notably the peaceful resolution of the Bougainville conflict, but also improved budget management and commodity prices during 2003 to 2004, improved political stability and recent signs of recovery in resource investments, especially the improved prospects for the Highlands Gas Project.

But huge challenges remain. PNG is facing difficult medium-term economic prospects, a breakdown in service delivery in many provinces, a looming HIV/AIDS crisis (with infection patterns resembling those of the early spread of HIV in sub-Saharan Africa), continuing environmental degradation, and a young population set to double over the next 20 years. Widespread and increasing youth underemployment, aggravated by increased rural-urban migration, is contributing to increased crime and social tension. Internal violent conflict in places such as the Southern Highlands, fuelled by political competition and the spread of guns also threatens stability and key resource assets. Natural disasters such as the Tsunami, volcanic eruptions and drought continue to be ongoing threats and the capacity to mitigate their effects, and deal with their consequences, remains weak.

The potential spillover effects of this on Australia and the region have been well documented in international literature on fragile states and more particularly in the recent ASPI report on PNG ‘Strengthening Our Neighbour’.<sup>53</sup> They range from geo-strategic concerns relating to Australia’s defence, to more immediate concerns with the possible impacts on Australia of transnational threats such as cross-border crime, international terrorism, disease pandemics, and people movement.

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<sup>50</sup> World Bank, Papua New Guinea: Interim Strategy Note, 2005.

<sup>51</sup> AusAID (2003) ‘The Contribution of Australian Aid to Papua New Guinea’s Development 1975-2000’, p ix

<sup>52</sup> Ibid.

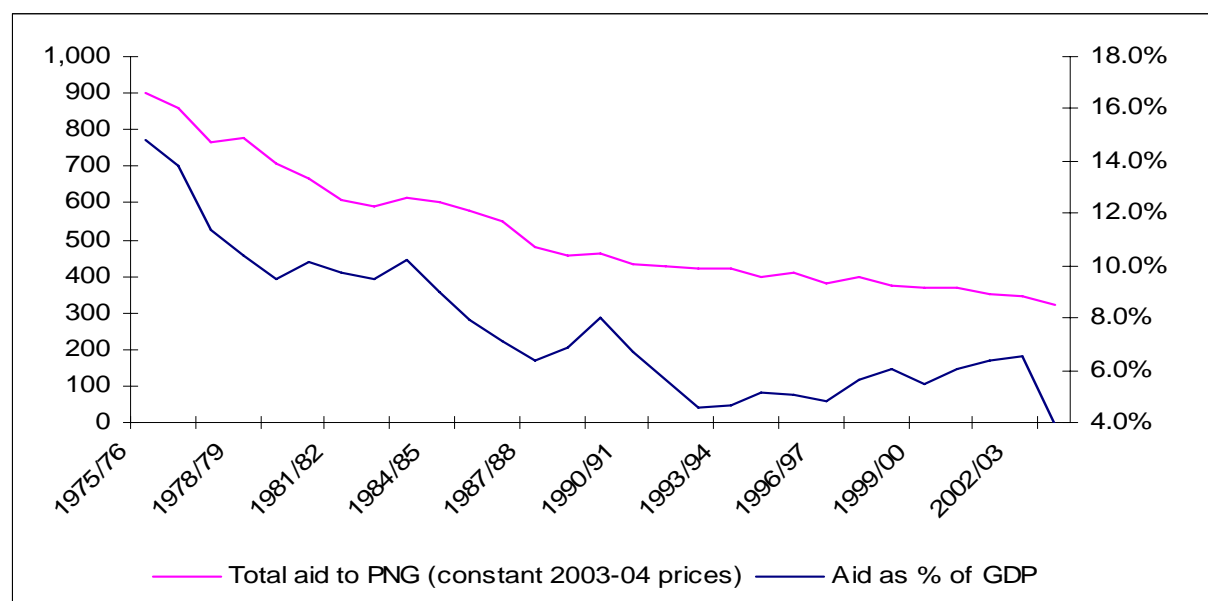
<sup>53</sup> Australian Strategic Policy Institute: Strengthening Our Neighbour—Australia and the future of Papua New Guinea, 2004

Australia therefore has a big stake in a policy of enlightened self-interest towards PNG, that combines our humanitarian and moral obligations as the ex-colonial and as the metropole power in the region, with our strong economic and strategic self-interest in supporting PNG to deal more effectively with the challenges it faces. Recent research on fragile states concludes that without assistance, fragile states have little prospect of overcoming their problems and are likely to experience ongoing fragility and stagnation for generations.<sup>54</sup> A recent OECD study indicates that once a state becomes fragile, it can remain that way for around half a century and cost around \$80 billion to remedy. The conclusion from these and other studies is that donors must invest in fragile states to avoid deterioration, addressing aspects such as law and order, service delivery and improved public administration and political governance.

## 2. *The evolution of Australia's aid engagement and its drivers*

Since Independence Australia has provided more than \$14 billion in real terms (\$9 billion in nominal terms) as official development assistance to PNG. Between 1975 and 1976 Australia's aid to PNG accounted for 60 per cent of the overall aid budget. Today the 'traditional' PNG country aid program accounts for about 12 per cent of total Official Development Assistance (ODA), and almost 20 per cent including ECP and other ODA-eligible expenditure by other Australian Government departments. It remains the largest of Australia's bilateral aid programs.

*Figure 1: Aid to PNG in real terms and as proportion of PNG GDP (1975–2004)*



Australia's aid since PNG independence continues a history of engagement going back to before World War Two. Australia's large scale post war involvement in PNG was prompted by a recognition, especially after battles such as Kokoda and Milne Bay, that PNG provides a physical barrier between Australia and Asia, and that PNG's political stability and economic development directly support Australia's national interests and

<sup>54</sup> Chauvet, L. and Collier, P (2005) 'Development Effectiveness in Fragile States: Spillovers and Turnarounds', Paper prepared for DAC Learning and Advisory Process on Difficult Partnerships.

national security. Australia was directly responsible prior to independence for establishing PNG's national infrastructure and institutions, including roads, schools, health system, justice system, and political boundaries. Major accomplishments included building the Highlands Highway and establishing more than 2,000 health facilities from aid posts to hospitals. In 1970 there were an estimated 55,000 Australian public servants working in PNG, including many in the remotest parts.

The sometimes tenuous sense of PNG national identity is partly due to the fact that nationhood emerged from the peaceful gift of a benign Australian territorial administration rather than principally from PNG's own initiative. Criticisms that Australia did not do enough to prepare PNG for independence should be set in the context of the large real achievements pre-independence, PNG's very low level of development, and the prevailing views of the 1970s about decolonisation and assumptions that financial transfers were the key to development.

Australia consistently has been PNG's largest development partner, providing well over half of PNG's external assistance. Over the years, multilateral agencies such as the World Bank and ADB have been the other major donors. World Bank and ADB programs are mainly based around concessional lending, although there has been significant technical assistance support. Japan is a significant bilateral donor, along with the EU.

Australia's aid program has evolved over the past 30 years through several key phases, outlined here.

### **Budget support**

Under Australia's decolonisation obligations to the UN, and perhaps more importantly, because of the close historical and geographic relationship, Australia considered PNG to be a high priority following independence. The Whitlam Government promised A\$500 million as direct budget support over the first three-year period, however this was reduced almost immediately by A\$36 million in the first year.<sup>55</sup> The budget support policies were continued in 1975 by the newly elected Fraser Coalition government,<sup>56</sup> which developed the initial five-year aid agreement with PNG from 1976 to 1981. Australian aid was crucially important for the PNG economy at the time of Independence, accounting for 41 per cent of central government's expenditure between 1974 and 75.<sup>57</sup> In addition, in the immediate post-independence period, a cadre of Australian advisers and specialists from the pre-independence administration still substantially supported the PNG government in a number of areas.

About 60 per cent of Australian aid to PNG since Independence has been provided in the form of untied budget support grants. Assessments of the impact of budget support vary. One view is that budget support contributed significantly to political, economic and social stability after the rapid transition to independence, and helped bridge the resource gap between PNG's high investment requirements and its low domestic savings. It was

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<sup>55</sup> Dorney, S (2001) *Papua New Guinea Since 1975*, 2<sup>nd</sup> edition , p 245

<sup>56</sup> A revised five-year package of \$180 million per annum was agreed by the Fraser Government, with the proviso that discussions commence on a formula to reduce 'dependence' on this form of aid (eventually agreed at two per cent reduction per annum)

<sup>57</sup> Commonwealth of Australia (1975) Budget Paper No 10 'Australia's Overseas Development Assistance 1975-76'

PNG's preferred form of support, enabling the new nation to set its own development priorities without interference from Australia. It was flexible, easy-to-administer and imposed no debts on PNG.

Analysis of PNG's own funding for different sectors indicates that government funding for key sectors such as infrastructure, health and education was higher when PNG was receiving budget support than in recent times, and contributed (in conjunction with better institutional quality) to the higher levels of service delivery over the 70s and 80s.<sup>58</sup> The beginning of the transition from budget support to programmed aid coincided with two other significant shocks to the PNG economy—the Bougainville crisis and the devaluation of the kina—and experts working in government in PNG at that time argue the combined revenue shocks resulted in a dramatic decline in operational budgets for service delivery.<sup>59</sup> Another (largely anecdotal) argument made by some commentators is that withdrawal of budget support over the late 80s and early 90s resulted in a rapid and steep reduction in the number of experienced expatriate advisers contracted by the PNG Government in in-line positions, and that this was a significant contributing factor to the rapid deterioration in institutional capacity in PNG during the 90s.

Other arguments for budget support are that it allowed aid to be spent in conjunction, and aligned, with domestic priorities. It avoided the problem of project aid being implemented outside domestic structures and creating parallel delivery systems that have little domestic ownership, overtax local administrative capacity, are not factored into domestic recurrent budgets, and often have weak sustainability. Another consistent objection to project aid from the PNG Government over the years has been the concern that many of the benefits accrued to Australian suppliers of goods and services—disparagingly referred to as boomerang aid.

The alternative view is that continuing budget support without ongoing policy engagement contributed to the deterioration of the overall budget and resource allocation process. It helped shield PNG from making hard decisions on economic policy and reducing government expenditure, producing a bloated and unproductive public service and encouraging rent-seeking over-productive investment. According to this view, along with large and poorly accountable resource revenues, budget support helped underwrite the 'hard kina' policy, distorting PNG's exchange rate and depressing agricultural production, which in other developing countries has been the key to broad-based development. Unconditional budget support also limited Australia's capacity to engage in policy dialogue with the PNG Government. Post-1975, most Australian government departments had little or no dealings with their PNG equivalents, and were not used by Australia to engage in ongoing discussions on policy and economic management issues in PNG and on national development thinking.

### Transition to programmed aid

In 1979 the Harries Report into Australia's relations with developing countries recommended that budget support to PNG be phased out and replaced with project aid having an Australian identity.<sup>60</sup> In 1980 Sir John Crawford undertook a review of support to PNG and recommended a gradual five per cent reduction in budget support volume

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<sup>58</sup> AusAID (2003) 'The Contribution of Australian Aid to Papua New Guinea's Development 1975–2000'

<sup>59</sup> Eg Jane Thomason, in comments on draft PNG Analytical paper.

<sup>60</sup> In AusAID (2004) 'Australia and Papua New Guinea: Development Cooperation History' (unpublished)

to PNG and annual aid level discussions on the mechanics of how ‘supplementary aid’ might function.<sup>61</sup> A second aid agreement, at a planned \$1,300 million for the period 1982–1986, was signed between PNG and Australia based on the Crawford report’s recommendations, but with a slower rate of decline.

In 1984 the Jackson Review of the Australian aid program recommended the phasing out of budget support at five per cent per annum and replacement by training and projects (Jackson noted that at this rate, budget support would still represent more than 50 per cent of the aid program between 2013 and 24). In the subsequent 1985 aid agreement, Australia and PNG agreed on a gradual reduction in the amount of Australian aid funding provided each year of at least three per cent per annum in real terms, combined with a gradual reduction in budget support and an increase in programmed assistance.

The shift towards programmed aid accelerated in 1989 with the signing of the first comprehensive Treaty on Development Cooperation (for a planned ten-year period). Under the Treaty the two countries agreed to shift budget support to programmed aid at a rate of \$37 million a year. The Australian Government’s intent was that budget support would be phased out ‘by 2005 or sooner if that can be achieved’.<sup>62</sup> A consequence of the relatively rapid shift to programmed aid was that much of AusAID’s effort over the 90s was taken up with the mechanics of programming \$37 million of new expenditure each year. By 1996–97 project aid had grown to nearly \$155 million a year, about half the aid program to PNG. The three priority sectors of education, infrastructure and health continued to receive the bulk of funds (in that order).

The 1997 Simons Review of Australia’s aid endorsed the shift to programmed aid, arguing it allowed more effective targeting of Australian assistance to areas of priority need, in support of PNG’s own development objectives.

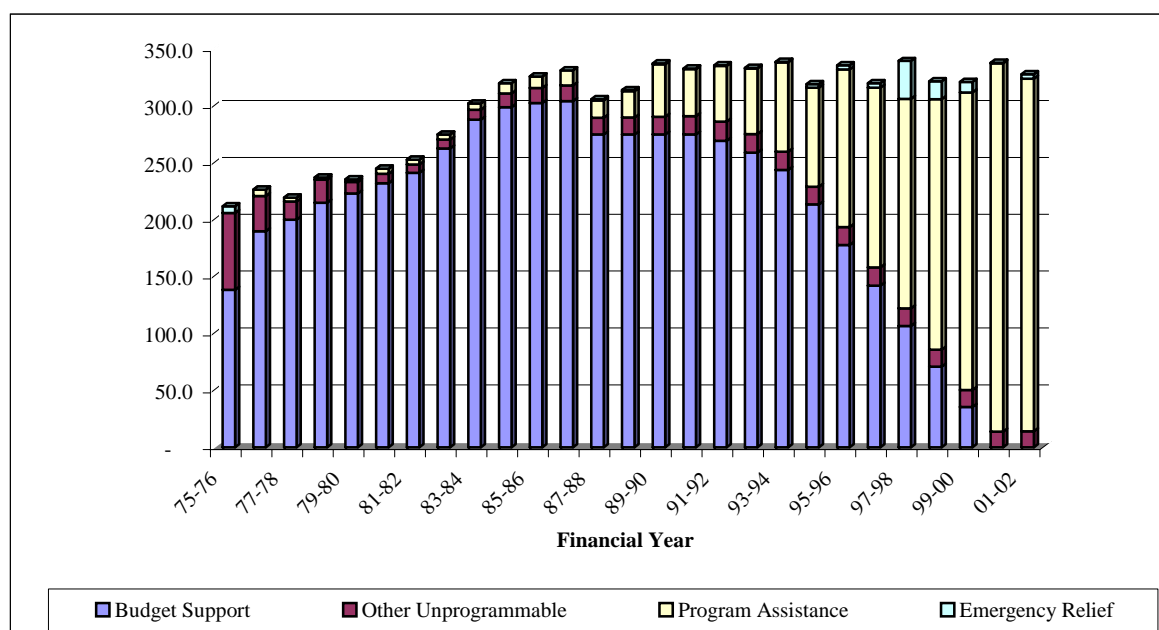
Over the 14-year period (1975 to 1989), programmed assistance accounted for only 2.7 per cent of Australian aid funding to PNG. By contrast, programmed assistance accounted for 45.5 per cent of Australian aid funding over the subsequent 14 years (1990 to 2003).

Following the second Aid Treaty review in 1995 both governments agreed to introduce performance benchmarks to monitor the implementation of programmed aid. Benchmarks were developed for health, education and forestry and performance against them was reviewed annually and reported to the annual bilateral Ministerial Forum. In 1997, for the first time, Australia’s aid contribution was incorporated into a ‘new’ development budget for PNG initiated by donors to improved budget transparency and ensure that aid flows are better integrated into PNG’s own development plans. The last budget support payment to PNG was made in 1998–99. Annex A provides a snapshot of changing emphases in aid program priorities in PNG from 1975 to 2000.

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<sup>61</sup> Ibid.

<sup>62</sup> AIDAB (1989) Australia’s Development Cooperation with PNG: Submission to the Joint Committee on Foreign Affairs, Defence and Trade Inquiry into Australia’s Relations with Papua New Guinea, p64.

**Figure 2: Changes in composition of Australian development assistance 1975–2003**

Source: Australia's overseas aid program statistical summary, AusAID, Canberra (various editions)

### Impact of programmed aid

An independent evaluation of Australia's aid in 2003 found that it had made a significant contribution to alleviating poverty in PNG, particularly towards improvements of 20 to 50 per cent since Independence in life expectancy, literacy levels, infant mortality rates and school participation rates.<sup>63</sup> In terms of programmed aid, it found that Australian aid has been a major influence on PNG's development achievements to date.<sup>64</sup> Key achievements include:

- Education: with Australian assistance, the number of children attending school doubled from 510,000 in 1992 to an estimated million in 2002.
- Health: Over the past 20 years Australia's assistance has helped reduce infant mortality by more than one third and increase life expectancy from 49 to 59 years.
- Transport: Australian aid has helped ensure that key roads and airports have stayed operational.

### 3. *Specific changes to increase development effectiveness over last ten years*

#### Evolution to program approach

As experience with programmed aid improved, there developed a greater understanding of the importance of affordability, of public expenditure management and of the requirement for aid to help build PNG's own capacity to manage and use effectively all

<sup>63</sup> Ibid, p21

<sup>64</sup> Ibid, pp33-49



its resources, not just aid resources. Over the late 90s AusAID began to shift its programming away from stand-alone projects towards a more integrated sector-based approach, to improve impact and sustainability and reduce the administrative burden on overstretched PNG systems. There was also an increasing realisation that projects were driving parts of the PNG system, especially in line agencies, rather than the program following PNG priorities and helping to strengthen PNG systems and capacity.

By the late 1990s AusAID and the National Department of Health had agreed to a SWAp in the health sector, aimed at better aligning Australian and other donor funds in support of the priorities of the PNG health system. From the experience of the health sector, AusAID has since formulated program approaches in the education and law and justice sectors, which also emphasise the principles of building capacity in the counterpart agencies, helping to strengthen policy formulation and priority-setting, and providing technical and financial resources to support implementation.

### Increased focus on governance reforms

By 1999 economic mismanagement under the Skate Government, following on from the instability and disinvestment generated by the Sandline crisis in 1997, had taken the PNG economy close to financial collapse.<sup>65</sup> The PNG parliament responded by electing the Morauta Government following the resignation of Prime Minister Skate.

#### *The Morauta Government and the Structural Adjustment Program*

Australia worked closely with the World Bank, International Monetary Fund (IMF), ADB, EU, and Japan (which came to be known as the 'Friends of PNG Group') to support a broad-ranging program of financial, economic and political reform developed by the new Morauta Government. The ambitious reform program became the centrepiece of a major World Bank/IMF SAP implemented between 1999 and 2001. During that period Australia's aid program provided substantial financial and advisory support to help PNG meet its SAP governance reform agenda.

Although the IMF program was successfully completed—a first for PNG—the long-term impact of the SAP reforms was limited. Substantial improvements in economic management between 1999 and 2001 were rapidly undermined by the unleashing of expansionary government expenditure in the run-up to the 2002 national election. Over the medium term, some important governance reforms under the SAP have been sustained, such as legislation of Central Bank independence, privatisation of the government-run PNG Banking Corporation and reform of the superannuation industry to insulate entities from political interference. Other major SAP reforms, such as the privatisation of other state utilities and reforms to the management of the forestry sector, have floundered. Yet others, in particular the public sector reform process and Constitutional reforms to introduce a more representative voting system and to strengthen the party system, are still works-in-progress.

The key lesson drawn by donors from their engagement with the SAP reform program was the need for a broader and more informed consensus on reform initiatives across the political and bureaucratic spheres in PNG, to ensure greater ownership. Another

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<sup>65</sup> Sugden, C (2002) "Correcting Papua New Guinea's costly economic cycles", in Pacific Economic Bulletin 17,2, 2002

important lesson was the need for a more gradual, incremental approach to reform that would not overwhelm already fragile institutions.

Over the same period of the late 90s and early 2000s, AusAID's implementation work in service delivery sectors, as well its developing engagement with issues of sub-national governance,<sup>66</sup> was increasingly highlighting that sectorally focused technical interventions—while important—were not sufficient to improve overall performance. It became clear that without reform of the process of resource allocation in PNG and improvements in the functioning of central agencies critical to it, service delivery could not be improved in a sustainable way.

### *The Somare Government and the PERR*

The combination of the lessons from the Morauta Government's SAP and the continuing need for reform of the resource allocation process and public administration led to engagement on a new reform program under the Somare Government. The new reform process is centred around a PERR program for PNG, developed by the PNG Government with technical support from the World Bank, and a Public Sector Reform Strategy (PSRS) 2003–2007.

Compared to the SAP, the current reform program has a sharper focus on public expenditure management and administrative reforms, and more modest objectives of gradually restoring the functionality of existing systems in PNG. The PERR and PSRS were developed with deeper and broader engagement across the PNG Government's key central agencies than was the case for the SAP public sector reform, which was driven largely by external advisers and the Chief Secretary's department, with limited buy-in from other central agencies. The PERR has brought together the World Bank and ADB, as well as AusAID, in support of the reform plan. Australia's support to date has helped implement important gains in procurement, debt management, civil service retrenchments, and expenditure control.

With donor harmonisation, the World Bank, ADB and Australia actively worked during 2002 and 2003 on the concept of a joint Country Strategy for assistance to PNG, which would form the basis for a joint program addressing priorities at the national, sectoral and provincial levels agreed with PNG. At present, there are a number of operational difficulties with this approach.

### **Increased focus on security and stability—the Enhanced Cooperation Program**

Following the Bali bombing and conflict in the Solomons, Australia's September 2002 Ministerial Aid Statement underlined the links between development and the stability and security of countries in the region. It also re-emphasised the centrality of good governance, especially sound economic management to promote rapid growth and good social policies. Another key message was the need for strong policy coherence between aid and foreign policy and the need for the aid program to coordinate effectively with other Australian government agencies and draw on the expertise available through them.

In line with this new policy approach, in December 2003, Australia and PNG agreed to a bold new initiative to address PNG's growing security challenges and to bolster the

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<sup>66</sup> In particular, AusAID (2000) 'Western Province, PNG: Development Status and Prospects'

existing engagement on budget management and public sector reform through the provision of Australian officials as in-line advisors in key PNG agencies.

The \$1.1 billion, five-year ECP envisaged the placement of up to 210 police with the PNG Royal Constabulary in Port Moresby, Lae, Mt Hagen, Bougainville, and along the Highlands Highway, as well as up to 64 senior Australian officials in key PNG agencies across the legal sector, in economic and public sector administration and in agencies dealing with border and transport security. The key objectives of the program were to address acute law and order problems, strengthen border security, tackle corruption, encourage robust financial and budget management by PNG, and help reform the public service. In terms of approach, a central tenet of the program was to build PNG capacity through the establishment of broad-ranging and long-term relationships between Australian and PNG institutions.

In May 2005 the PNG Supreme Court decided that elements of the Treaty covering the ECP are unconstitutional. The program's future is now subject to negotiation between the Australian and PNG governments.

### ***Increased focus on sub-national governance***

Especially since the 1995 decentralisation reforms, core responsibility for delivering many services in PNG rests with provincial and local administrations. But in many provinces, public administration and basic service delivery at the sub-national level are failing due to inequitable funding arrangements between provinces, poor planning and resource allocation, mismanagement within provinces and local government, increasing levels of corruption, and confusion about the roles and responsibilities of different levels of government following the 1995 reforms.

The SNI is AusAID's response to PNG's decentralised system. Built on lessons learnt from implementing sector-wide approaches and from AusAID-supported analytical work on PNG's intergovernmental financing arrangements, the initiative has three objectives:

1. to improve the PNG National Government's ability to support and supervise sub-national levels of government
2. to support sub-national levels of government to meet their service delivery mandates
3. to improve the impact of the aid program by increasing consultation with both levels of government and improving coordination between program sectors.

Specific engagement strategies are being developed for poor performing provinces such as Southern Highlands and for provinces of special interest to Australia such as Bougainville. The program is being trialled in three pilot provinces—Eastern Highlands, East New Britain and Central Province—with full-time budget advisers mobilised to these provinces in October 2004. AusAID will support its management of SNI through co-locating five AusAID staff in the key national Department of Provincial and Local Government Affairs and the provincial administration in each pilot province.

The SNI supports and complements the aid program's work with central agencies to help improve fiscal discipline and ensure appropriate expenditure in key sectors. It is also consistent with the PERR process.

## Increased focus on civil society and political participation

Much of the budget management and public sector reform work of recent years necessarily has focussed on the supply side of governance, which emphasises building leadership and management capacity in key central agencies and providing technical support to the reform process. More recently, the aid program has also begun working to strengthen demand for improved governance through:

- Increased support for churches and non-government organisations to deliver services and to pressure national, provincial and local governments for better service delivery.
- Support for the media sector, particularly rural radio, to improve access, content and voice.
- Support for fairer and more representative elections and political representation, including through support for the implementation of PNG's new limited preferential voting system and for voter education to build popular understanding and demand for political accountability.
- Strengthening oversight and accountability bodies like the Parliament, key Parliamentary Committees (especially the Public Accounts and HIV/AIDS committees), and the National Audit Office and the Ombudsman Commission, which provide avenues for public scrutiny of government functions.

### 4. *Other external factors and program responses over the last ten years*

As the volume of available programmed assistance increased during the 1990s, the areas prioritised for Australian support were influenced by drastic changes that occurred in PNG's own circumstances. The program responded effectively to the Rabaul volcano eruptions of 1994, the need to restore peace and provide welfare support on Bougainville, serious drought and frosts in 1997–98, and the devastation caused by the Aitape Tsunami in 1998. The program has also supported PNG to respond to several other natural disasters, including most recently the resettlement of 10,000 people following volcanic activity on Manam Island.

Over the last ten years PNG has faced several fiscal upheavals, in particular the Asian financial crisis of 1997. On several occasions Australia used the aid program to support PNG through fiscal crises by helping to meet some priority PNG Government budget outlays such as contributions to church health services and the school fee subsidy.

The aid program has also played an important catalytic role by sponsoring analytical work on PNG, that has contributed to putting issues such as the threat posed by HIV/AIDs in the public domain.

Some of the major program responses and developments are noted here.

### **Bougainville peace process and conflict prevention work**

Australian assistance has played a key role in bringing peace to Bougainville. Since 1997, more than \$200 million has been provided through the aid program to support the peace process and the province's post-conflict recovery, including the successful conduct of the recent elections for a Bougainville autonomous government. In particular, AusAID provided \$7 million over five years to support the operation of the Bougainville Peace Monitoring Group, which promoted stability and built confidence in the peace process

on Bougainville. The neutral and unarmed group included more than 40 AusAID staff serving as civilian monitors. As the peace process consolidated, in 2003 it ceased operations and was replaced by a small civilian-led Bougainville transition team funded principally by AusAID.

The aid program has also supported conflict prevention measures in the volatile but economically important Southern Highlands province. These included substantial financial support for enhanced security in the 2003 supplementary elections, support for conflict resolution work by local NGOs, the rehabilitation of Mendi High School in partnership with local oil firm Oilsearch, and the development of a conflict vulnerability analysis for the province that will guide future program development.

## HIV/AIDS

In 2002 an AusAID-commissioned report—*Potential Impacts of an HIV/AIDS Epidemic in Papua New Guinea*—first raised the alarm about the looming HIV/AIDS crisis facing PNG. The report projected that deaths from HIV/AIDS could reach more than 120,000 per year by 2020 under a worst-case scenario. The economic impact would include reductions in the labour force between 13 and 38 per cent and increases in the budget deficit between nine and 21 per cent by 2020. HIV prevalence in PNG is now approaching two per cent of the adult population, with infection rates increasing annually by 15 to 30 per cent, a pattern similar to that experienced by sub-Saharan Africa. As the epidemic progresses it strains education systems, weakens demand, widens the gender gap, and potentially leads to increased costs across all sectors of the economy. AIDS patients already regularly occupy more than 50 per cent of medical ward beds at Port Moresby General Hospital.

The centrepiece of Australia's response has been the \$60-million National HIV/AIDS Support Project (NHASP), which works with PNG's National AIDS Council. The project commenced in October 2000 and operates in all PNG provinces. With NHASP due to finish in late 2005, AusAID is currently working with the PNG Government and other development partners to develop a new program of support. It seems clear that Australia will need to play a significant role in helping PNG address its emerging HIV/AIDS epidemic, and Australia's International HIV/AIDS Strategy (AusAID 2004) commits AusAID to mainstreaming HIV/AIDS across its development cooperation activities. AusAID's draft HIV/AIDS thematic report concludes that 'an immediate priority should be accorded to elevating the breadth and depth of the response to HIV/AIDS in PNG. (p. 32). The draft report also notes, however, that in PNG, national and provincial AIDS councils have been under resourced and unable to operate effectively, central government leadership has been mixed on HIV/AIDS and there is planning confusion. And for mainstreaming to work finance and planning ministries that control budgets and negotiate the terms of foreign assistance must have HIV/AIDS as a clear priority.

## Enclaves or equity report

This 2001 AusAID report helped to highlight the serious social and economic crisis in rural PNG, the risks from projected declines in mineral and oil revenues to 2010 and the need for national economic policy to prioritise investments that would benefit the neglected majority in rural areas. It was a key driver to the development by PNG of a Medium Term Revenue and Expenditure Framework to help guide economic policy.

## Incentive fund

An important initiative in 2000 was the establishment of the PNG Incentive Fund to support organisations both within and outside government that demonstrate excellence and financial accountability in delivering community and public services. The program was designed to support reform agents in PNG and to create incentives for performance at an institutional level.

### 5. *Evaluations of the PNG aid program and lessons learnt*

Two major external evaluations of the program have been undertaken in recent years—an external rapid impact assessment of Australian aid since Independence undertaken in 2003 and a Joint Aid Review with the PNG Government in 2004. AusAID has also undertaken its own regular evaluative work at project and program levels and further analytical work, on its own and in concert with other donor partners (in particular the World Bank and the ADB). Most recently, this analytical work has started to draw on lessons emerging from recent international research on fragile states. Several common themes emerge in lessons learnt, which are summarised here.

#### Aid philosophy

There is a need:

- to have realistic expectations—Australia’s aid, while significant, is still only about 20 per cent of PNG’s development budget. Aid is also only one element of a broader bilateral relationship. PNG is still a young country with fragile governance
- for a consistent, long-term approach, working in concert with other development partners
- to work within existing structures and systems, not duplicate them
- for the aid program to retain flexibility to respond to emerging requirements, while avoiding stepping in to fund activities for which the PNG Government should accept responsibility. Careful consideration should be given to avoiding distortionary expenditure and substitution of Government of PNG funding by the aid program.

#### Aid relationship

There is a need:

- to strengthen the quality of the partnership between Australia and PNG officials working on the aid program through a clearer policy framework, clearer lines of communication between AusAID and Government of PNG with explicit means of resolving differences, and agreed processes of consultation when either party is considering a significant change in policy or approach
- for an annual Joint Country Effectiveness Review to monitor strategy performance, to improve both governments’ understandings of development perspectives, and enhance the quality of dialogue generally
- for both governments to share a common view on an appropriate development strategy for PNG if aid funds are to work effectively in concert with PNG’s own resources. PNG’s expenditure outcomes, as well as the allocation of Australia’s aid, must be closely aligned to those agreed priorities

- to continue to shift from foreign technical assistance to a stronger focus on greater use of local resources. The role of Australian contractors should shift from managing programs to providing credible technical support
- to move towards a joint strategy approach with the IFIs, other major donors and the PNG Government, to help PNG address its highest priority challenges at central, sectoral and provincial levels.

### Development strategy

There is a need:

- for Australia's development strategy to focus on helping improve the use of *all* resources available to PNG, not just the 20 per cent from donors and the development banks. To achieve this, Australia's aid must support PNG's central agencies to direct and manage coherent budget processes and to provide the leadership for structural reform (which will be gradual)
- to continue to support policy and management improvements in line agencies in key sectors, and to increase the aid program's focus on provinces by engaging with sub-national governments responsible for delivering most services to the rural majority
- for the strategic and operational links between the ECP and the rest of the aid program to be strengthened
- to continue to explore how aid can more strategically leverage change within sectors and between sectors, central agencies and provinces. Strategies include negotiating on resource allocation, performance-based funding approaches and strengthening core systems of governance.

### Emerging priorities from fragile states and other international experience

There is a need:

- to reprioritise broad-based growth, while continuing to engage on and support governance reforms
- for a stronger focus on improving rural incomes by facilitating agricultural production and marketing
- for more emphasis on improving access to information in rural areas, to improve social cohesiveness and to help link producers to market information
- to maintain service delivery through alternative service providers where state provision has broken down
- for stronger levels of engagement with local communities, identifying their priorities and targeting their opportunities
- for greater focus on political economy and analysis of social drivers and constraints to change
- to re-double efforts to work with Government and other partners to tackle the HIV/AIDS epidemic.

## 6. Conclusions

- Since Independence, Australia's aid program has contributed substantially to overall improvements in health and education and has helped PNG avoid further deterioration in other key sectors.

- The program responded flexibly and effectively to a wide range of major events that beset PNG, including natural disasters, fiscal crises and the Bougainville conflict, and played a major role in helping PNG overcome these crises.
- AusAID's analytical work in the early 2000s played a key role in raising the alarm on the looming HIV/AIDS crisis and on the rural crisis facing PNG. The aid program has supported and underwritten much of the response to the HIV/AIDS epidemic in PNG to date.
- In recent years the program has evolved rapidly away from stand-alone projects and towards sector-based and program approaches focussed on building PNG policy, management and implementation capacity. The devolution of program management functions to AusAID's Port Moresby office has given strong leadership and purpose to this shift.
- Particularly over the last five years, the aid program has been heavily involved in governance reform, particularly economic governance, public sector and machinery of government reforms, governance reform at the sector level, and increasingly, political governance.
- Reform efforts have been bolstered through increasing Australian whole-of-government engagement in PNG, culminating in the ECP.
- The program has also developed a new initiative to engage on reform of sub-national levels of government, which have primary responsibility for many service delivery functions.
- Over recent years the program's quality has benefited from devolution and stronger analytical capacity in AusAID, resulting in substantial knowledge gains. Lessons from our own experience in PNG and from international experience especially in fragile states are being effectively integrated into the development of a new Country Strategy.



### *Evolution of Australian aid objectives in Papua New Guinea*

Year	Catalysts	Objectives	Priorities
1975	<ul style="list-style-type: none"> <li>□ Independence</li> <li>□ Somare Government emphasis on equity and stability, rather than growth</li> </ul>	<ul style="list-style-type: none"> <li>□ to assist PNG achieve a smooth transition to Independence and enable it to continue its development strategies in the post-independence period</li> </ul>	<ul style="list-style-type: none"> <li>□ to enable PNG to set its own development priorities</li> <li>□ to bridge the resource gap between PNG's high investment requirements and low savings</li> <li>□ to ensure PNG is able to maintain a stable, viable and united country after its rapid transition to Independence</li> </ul>
1980	<ul style="list-style-type: none"> <li>□ high expectations for minerals sector</li> <li>□ Crawford Review</li> </ul>	<ul style="list-style-type: none"> <li>□ to enable PNG to pursue its economic development policies with assured funding while, at the same time, meeting its stated objective of self-reliance</li> </ul>	<ul style="list-style-type: none"> <li>□ to reduce budget support gradually and predictably</li> </ul>
1982	<ul style="list-style-type: none"> <li>□ impact of world recession affects PNG economy, particularly mining sector—fall in gold prices, declining Bougainville copper profits</li> </ul>	<ul style="list-style-type: none"> <li>□ to provide PNG with a practicable framework in which to plan its development</li> </ul>	<ul style="list-style-type: none"> <li>□ to ease the rate of decline of budget support</li> </ul>
1986	<ul style="list-style-type: none"> <li>□ introduction of project aid</li> <li>□ Wingti Government emphasis on economic growth, away from social services</li> </ul>	<ul style="list-style-type: none"> <li>□ to accelerate progress towards self-reliance</li> <li>□ in addition to budget support, to introduce a country program using a range of instruments (projects, training, scholarships, and technical assistance)</li> </ul>	<ul style="list-style-type: none"> <li>□ revenue generation</li> <li>□ institution strengthening for key economic departments</li> <li>□ technical assistance for state enterprises</li> <li>□ management development in the departments of health, works, police, and justice</li> </ul>

Year	Catalysts	Objectives	Priorities
1989	<ul style="list-style-type: none"> <li>❑ First Treaty</li> <li>❑ Namaliu Government increased priority of social sectors</li> </ul>	<ul style="list-style-type: none"> <li>❑ to promote self sustaining economic growth with equity and contribute to PNG's stability and social cohesion</li> <li>❑ to reduce progressively the overall level of Australian aid, shifting from budget support to project aid</li> <li>❑ to maintain support within Australia for aid to PNG</li> <li>❑ to consolidate the geographic spread of Australian aid and achieve an appropriate balance in sectoral emphasis between projects supporting economic growth and those supporting social development</li> </ul>	<ul style="list-style-type: none"> <li>❑ human resource development and institution strengthening, especially at provincial level</li> <li>❑ rural development</li> <li>❑ civil aviation</li> <li>❑ forest and environmental management</li> <li>❑ continued support for law and order projects</li> <li>❑ revenue generation (taxation/customs)</li> </ul>
1995	<ul style="list-style-type: none"> <li>❑ economic recovery program following 1994 financial crisis</li> <li>❑ devolution to provincial governments</li> </ul>	<ul style="list-style-type: none"> <li>❑ to assist PNG meet its objectives of greater self-reliance, economic stability, social and gender equity, and poverty alleviation</li> <li>❑ to strengthen PNG's abilities to develop sectoral policies, improve basic service delivery (especially in rural areas), foster investment, and create employment.</li> </ul>	<ul style="list-style-type: none"> <li>❑ health</li> <li>❑ education and training</li> <li>❑ transport and communication</li> <li>❑ renewable resources</li> <li>❑ law and justice</li> <li>❑ private sector development</li> </ul>
1998	<ul style="list-style-type: none"> <li>❑ recovery from major drought in 1997</li> <li>❑ restoration of peace on Bougainville</li> </ul>	<ul style="list-style-type: none"> <li>❑ to promote sustainable development, self-reliance, stability, and social cohesion</li> <li>❑ to assist with implementation of PNG's economic reforms</li> <li>❑ to strengthen PNG's ability to improve basic service delivery (especially in rural</li> </ul>	<p>Same sectors, but emphasis on:</p> <ul style="list-style-type: none"> <li>❑ maximising involvement of PNG agencies in delivery, including project funding through PNG agencies</li> <li>❑ greater NGO involvement</li> <li>❑ increased commodity</li> </ul>

Year	Catalysts	Objectives	Priorities
		<p>areas), implement development programs, foster investment, and create employment</p> <ul style="list-style-type: none"> <li>□ to enhance PNG's capacity to plan for devolution of service delivery responsibilities to provinces</li> </ul>	<p>supply</p>
2000	<ul style="list-style-type: none"> <li>□ Second Treaty</li> <li>□ budget support phase-out completed</li> </ul>	<ul style="list-style-type: none"> <li>□ to relieve poverty and achieve sustainable development</li> <li>□ to introduce contestability among PNG organisations seeking aid funds</li> </ul>	<ul style="list-style-type: none"> <li>□ strengthen governance</li> <li>□ improve social indicators</li> <li>□ build prospects for sustainable economic growth</li> <li>□ consolidate the peace process in Bougainville</li> </ul>

## Attachment IV—Exemplar innovations and lessons learned: Executive summary

[Note: This document is a summary of a much larger and more comprehensive analysis of what has worked and why—lessons learnt. That document is available if requested]

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This Attachment provides a cursory executive summary of information provided by various sections within the PNG Branch of AusAID in response to requests for information to feed into the AusAID White Paper process. It highlights lessons learnt, innovative approaches, and what has worked in the particular program areas. Not every section addresses all these points. All original documents are included as appendices.

### *General overview*

A major focus of the PNG 2004 Joint Independent Review of the Australia's aid program to PNG was to recommend how to improve aid effectiveness. Key findings include:

- underlining the importance of good public management to ensure most effective use of PNG's total resource envelope (aid plus PNG's own resources)
- the importance of constructive engagement between officials of both governments
- noting that AusAID's good relationships were also an important building block for an effective aid program
- the need to develop and improved performance framework for the PNG program
- recognising the importance of the Country Strategy process as a way to improve aid effectiveness
- underlining the importance of improving donor coordination.

### *Governance*

Under governance there are several contributing programs or projects (including the *Sub-National Initiative*, the *Public Expenditure Review Rationalisation* exercise, *Law and Justice, Elections* (within Civil Society), and the *Ombudsman Commission*, included further in this summary.

AusAID's experience in governance with PNG's disparate society and culture highlights issues such as the disjuncture between traditional systems and the Westminster model (technical aspects of parliamentary operation are often more important to donors than to local people), weak governance systems, a policy poor environment and consequently poor fiscal management and service delivery (see PERR). The focus of the aid program's current support to the sector is to back genuine reformers in efforts to strengthen existing institutions. AusAID's strong preference is to support existing alliances and PNG-led initiatives.

Successful projects such as the Ombudsman Commission Institutional Strengthening Project (OCISP) have taken account of the need for sufficiently senior leadership and strong performers to progress the issues. At the other end of the scale, the work of civil society and the SNI (see below) in promoting broad demand for good governance is critical.

## *Donor coordination*

### **Joint Country Strategy**

In response to a generally worsening economic situation in PNG, AusAID, the World Bank, the ADBank and the Government of PNG agreed to devise a JCS for development, which would be a new mode of engagement between PNG and its development partners. The strategy aimed to draw on the comparative strengths of each partner to improve aid effectiveness, through analytical foundational work, a common strategic framework, and complementary (parallel) programs by each partner. Closer coordination with other development partners was also anticipated.

Although the process was halted, significant lessons were learnt. These included the importance of local ownership, leadership and early participation of all parties, clearly understood expectations from the outset, recognition of comparative advantages, and flexibility to deal with changing country conditions.

### **The Public Expenditure Review and Rationalisation Exercise: (ANNEX 3)**

The PERR is an example of highly successful joint donor coordination, led by the World Bank, between the bank, the Government of PNG, Australia, and the ADB. The PERR exercise helped facilitate a broadly shared understanding among a wide range of stakeholders of what constitutes an appropriately sequenced reform agenda for public expenditure management.

The PERR analysis and process helped, for example, to:

- frame discussions on issues such as prioritisation of reform agenda
- develop analytical expertise within the client government
- increase government interest and enhance ownership of subsequent reforms
- support understanding of the importance of central agency leadership in improving government effectiveness
- formulate and coordinate our engagement among a wide range of stakeholders.

AusAID can complement the banks' essential analytical role by engaging at the political level and encouraging follow-up missions by the bank, to keep the reform agenda invigorated. Encouraging the development of a specific diagnostic tool for small fragile states, combining current tools, would also assist engagement and streamlining of processes.

### ***Sub-National Initiative***

The SNI is an innovative approach, responding to PNG's need for support in delivering services to its people within its decentralised government framework. Its goal is supporting programs and initiatives of the Government of PNG, which focus on sub-national government performance. This is where the primary responsibility lies for financing services such as health, basic education and infrastructure.

The catalyst for the SNI was the failure of the PNG decentralised government system in service delivery. The initiative was developed from lessons learnt while implementing

sector-wide approaches, especially in health, acknowledging that sectoral-based programs were comparatively ineffective in an environment of weak governance.

Innovative aspects of SNI include:

- working from national and provincial government levels, promoting better communication and coordination across government
- co-locating AusAID staff in key PNG national and provincial government departments, which helps reduce fiduciary risks and contributes to policy and reform agendas. This new management model will be used as a pilot for other program areas
- using existing funding and funding mechanisms, primarily through the policy stream of the PNG Incentive Fund.

### *Law and justice*

AusAID supports law and justice in PNG through a sector based program. This is both innovative and ambitious. Experience suggests that supporting partner government systems and policies leads to more sustainable improvements in institutional capacity and service delivery. Outcomes, however, rely heavily upon commitment of both the donor and partner governments. It must also be acknowledged that significant improvements can take longer than in traditional donor driven initiatives.

PNG and Australia also recognise that by focussing on sector level objectives, assistance can be targeted to areas with the greatest potential for sustainable improvements, rather than simply on good performers for the purposes of quick wins. There is now increasing evidence of effective joint responses addressing sector, rather than agency objectives, and a decreasing reliance on donors.

### *Civil society*

AusAID's long-standing experience in working with civil society in PNG has highlighted the central importance of local ownership and participation at all stages of projects and programs. This can be ensured by supporting visions that emerge from the community, or can be generated through participatory approaches and community contributions. Without such considerations and approaches, conflict can be created or exacerbated and projects are less likely to be successful or sustainable.

These lessons have led to innovative and differing partnership approaches such as the Media for Development Initiative and the Church Partnership Program (Annex 6). There is focus on dialogue, joint decision making, facilitation of relationships, and consultation, all of which promote local ownership, interest and sustainability.

### **Elections**

Within the Civil Society Program, AusAID supports improvements in the PNG electoral system. The focus is on building a stronger community constituency and demand for better governance. Lasting reforms are likely to take time and need longer term engagement. A partnership between the PNG Electoral Commission and civil society groups may be important for overcoming challenges in some locations of electoral malpractice (Annex 6).

### *Infrastructure*

A key challenge with PNG infrastructure was finding ways to link road maintenance expenditure to public sector reform and budget management. Through PERR and discussions with PNG, AusAID and the Government of PNG, on the economic value of roads, an innovative solution emerged, linking the public sector redundancy program with funding needed for road maintenance. That AusAID was involved in initiating activities on different fronts helped open up the opportunity for such linkages.

### *Health sector*

Over the last five years or so, the PNG National Department of Health (NDOH) has led the development of a new means of working in the health sector, called a Sector Wide Approach (SWAp), named the Health Sector Improvement Program (HISP). In many ways this is able to support and build upon broader reform efforts the NDOH is pursuing within the sector.

Taking a sector-wide approach emphasises donor coordination and allows the NDOH to demonstrate and develop leadership and organisational capacities. However, in moving from a project approach to a SWAp, there is increased focus on, and engagement with, the National Government through contractors. There are risks of neglecting NGO/Church engagement, or increasing the separation between AusAID and the Government and contractors. Funding must be considered. There are elements within the SWAp which contribute to a focus on strengthening and supporting areas such as transparency, accountability, and priority setting of Government of PNG.

Within the Health SWAp AusAID has been developing a new health activity called the Capacity Building Service Centre (CBSC), due to commence its inception phase in August 2005. This will include embedding TA with Government of PNG, using Government of PNG funding sources and taking a partnering approach to contracts.

### *Bougainville*

Australia's aid program to Bougainville has taken a new direction since late 2003. The *Framework for Australian Aid Assistance to Bougainville 2004–2008* reflects a more forward looking and strategic approach than the previous approach of responding to the crisis situation. The key objectives of the framework are:

- assisting with the implementation of autonomy and public sector reform
- improving essential service delivery
- promoting economic growth.

The Governance and Implementation Fund (GIF) is an innovative approach to financing this support. The GIF is aimed at improving public expenditure management, local decision making, better donor coordination, promoting accountability, and public sector reform. Through the GIF priorities are determined by the Bougainville Government and agreed to by donor partners. Contributions are performance based, in line with improvements in key governance areas.

Achievements and lessons learned in the first 18 months of GIF's operation include:

- without the GIF, progress towards autonomy would not have advanced
- Government of PNG and Bougainville leaders have been brought together

- it has helped re-establish knowledge and use of appropriate Government of PNG financial systems and practices, and increase confidence in budget planning
- increased confidence in planning, knowing the resource envelope
- for AusAID it has reduced ad hoc requests for aid, allowing better targeting, and increased engagement, but it is heavily reliant on TA and AusAID staff time
- other donors have been reluctant to contribute without direct attribution being made
- the approach has taken time to evolve and must be understood as long-term in nature.



## Glossary

ADB	Asian Development Bank
ASPI	Australian Strategic Policy Institute
CACC	Central Agencies Coordinating Committee
CIE	Centre for International Economics
DAC	Development Assistance Committee
DFID	United Kingdom's Department for International Development
DPLGA	Department of Provincial and Local Government Affairs
DRIP	District Roads Improvement Program
ECP	Enhanced Cooperation Program
EU	European Union
GIF	Governance and Implementation Fund
HSIP	Health Sector Improvement Program
IMF	International Monetary Fund
JBIC	Japanese Bank for International Cooperation
JCS	Joint Country Strategy
JICA	Japan International Cooperation Agency
LICUS	Low Income Country Under Stress
MDG	Millennium Development Goals
MP	Minister of Parliament
MTDS	Medium Term Development Strategy 2005-2010
NDOH	National Department of Health
NEC	National Executive Council
NEFC	National Economic and Fiscal Commission
NHASP	National HIV/AIDS Support Project (NHASP)
NIP	National Indicative Program
NPRS	National Poverty Reduction Strategy
OCISP	Ombudsman Commission Institutional Strengthening Project
ODA	Official Development Assistance
PERR	Public Expenditure Review and Rationalisation
PNG	Papua New Guinea

PPII	Provincial Performance Improvement Initiative
PSRS	Public Sector Reform Strategy
SAP	Structural Adjustment Program
SNI	Sub-National Initiative
SWAp	Sector Wide Approach
TDC	Treaty on Development Cooperation
TRIPS	Transport Infrastructure Priorities Study