

**Review
of the
PNG-Australia
Development Cooperation Treaty
(1999)**

19 April 2010

Disclaimer: The views in this report are those of the Independent Review Team and not necessarily those of the Governments of Papua New Guinea or Australia.

Preface

In April 2009, Prime Ministers Somare and Rudd agreed to undertake a review of the PNG-Australia Treaty on Development Cooperation (1999), which guides the Australian aid program to PNG. The terms of reference for this exercise, attached at Annex 2, were agreed between the two Governments in June 2009. The overall aim of the review is “to consider and recommend how Australia’s aid can most effectively contribute to PNG’s current, medium and long-term development priorities.”

An Independent Review Team was commissioned. This consisted of Associate Professor Eric Kwa, the nominee of the Government of Papua New Guinea, Professor Stephen Howes, the nominee of the Government of Australia and Dr Soe Lin, the joint nominee of the two Governments.

The methodology adopted by the Independent Review Team has three complementary strands. First, we have consulted widely, getting as much feedback from as many stakeholders as possible (see Annex 1 for a listing). We held two rounds of consultations, in January-February and March 2010, in both Papua New Guinea and Australia, both before and after our draft report, which was released to both Governments on March 1, 2010. Second, we have benefited from the substantial evaluation literature available on the Australian aid program to PNG. Finally, we have drawn on the broader literature on development and aid effectiveness, and lessons from cross-country experience.

The Review looks back over the last decade since the time the Development Cooperation Treaty was signed in 1999. In looking forward, we have a similar time period of a decade in mind. We are aware of the importance of the LNG project for PNG. We were informed that, while dividend payments would commence earlier the bulk of revenues would start to flow once tax payments commence in around 2018. Hence, for most of the period we are concerned with, there will not be large revenues flowing to the PNG Government from the LNG project.

The development cooperation program is a joint responsibility of the PNG and Australian Governments. In this context, while the Review commonly refers to ‘Australian aid to PNG,’ this should not be taken to mean that we are making recommendations to the Australian Government for what it should do with its aid. Unless specified to the contrary, our recommendations are to both Governments.

After a list of main messages and an executive summary, the report proper begins with a background section which sets out the development context in PNG, and the history of Australia’s aid to PNG. It then tackles in Sections 2 to 10 the nine tasks contained in the Review’s terms of reference, following the sequencing used therein.

Acknowledgments and dedication

Our first debt is to the many, on both sides of the PNG-Australia relationship, who gave freely, and often more than once, of their time and advice, and who answered our many questions. A list of those to whom we are thus obliged is provided in Annex 1. We apologize to any inadvertently omitted.

Our second debt is to the Review's Secretariat – Catherine Gill of AusAID, Jon N'dramei of the PNG Department of National Planning and Monitoring, and Buri Gari of the PNG Department of Foreign Affairs and Trade – without whom this report simply would not have been possible. The Secretariat not only played a vital logistical role, but was also an important source of good ideas and information.

Our third debt is to the two Governments of Papua New Guinea and Australia, for commissioning this review, and for honouring us with the task of writing it. We are also grateful to the United Nations Development Programme (UNDP) for supporting the participation of Dr Soe Lin in this exercise.

This Review is dedicated to the memory of Enaha Kwa.

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Abbreviations and acronyms

ASF	Advisory Support Facility
AusAID	Australian Agency for International Development
DCT	PNG-Australia Development Cooperation Treaty (1999)
DNPM	Department of National Planning and Monitoring
DPLGA	Department of Provincial and Local Government Affairs
ECP	Enhanced Cooperation Program
GDP	Gross Domestic Product
GoPNG	Government of Papua New Guinea
HSIP	Health Sector Improvement Program
IMR	PNG Institute of Medical Research
L&J	Law and Justice sector
LLG	Local-level Government
LNG	Liquefied Natural Gas (project)
MDGs	Millennium Development Goals
MTDP	Medium Term Development Plan
MTDS	Medium Term Development Strategy
MTEF	Medium Term Expenditure Framework
NEFC	National Economic and Fiscal Commission
NGO	Non-Government Organisation
NRI	National Research Institute
OBE	Outcomes-based education
ODA	Official Development Assistance
ODE	AusAID's Office of Development Effectiveness
ODI	Overseas Development Institute
OECD	Organisation for Economic Cooperation and Development
OECD DAC	OECD Development Assistance Committee
PSWDP	Public Sector Workforce Development Program
SGP	Strongim Gavman Program
SNS	Sub-national Strategy
SWAP	Sector-Wide Approach
TA	Technical Assistance
UNDP	United Nations Development Programme
UPNG	University of Papua New Guinea

Note: The \$ sign refers to Australian dollars unless indicated to the contrary.

Main messages

Whilst the full report and its executive summary is organized around the nine tasks articulated in the Review's terms of reference, this opening section provides the cross-cutting messages which emerged from our consultations and analysis.

The status quo is not an option. There is widespread dissatisfaction with the aid program in both Papua New Guinea and in Australia, at various levels, political, bureaucratic, stakeholder, and in the media. There is a perceived lack of impact, and failure to obtain value-for-money. While some recognize its values and stress achievements, others are more dismissive of the program as a whole. These perceptions themselves would be a cause for concern, but they also reflect a growing body of evidence which strongly suggests that substantial change is needed. And, indeed, we found an appetite for change, and a hunger for fresh ideas and approaches. We were encouraged by our interlocutors to be bold and to set out new directions for the aid program. In this spirit, while we welcome the Australia-PNG Partnership for Development, agreed in August 2008, as a positive initiative, we see it as marking the beginning of a process of reform, not the end.

Bring the aid program into line with new realities. When Australian aid to PNG began 35 years ago, it exceeded PNG's own revenue, and equalled PNG-Australia trade. Today it is one-tenth of government revenue, and one-tenth of bilateral trade. The aid program is yet to adjust to and reflect these new realities. More than ever, PNG's destiny lies in its own hands, and aid will at best have a marginal impact on the country's development outcomes. While Australia's aid will always ultimately be judged by PNG's success, the Australian aid program also needs, but currently lacks, its own realistic standards by which to judge impact. Also, over time, as the aid program has become a smaller part of the PNG economy, it has been spread so thinly that its impact has become hard to discern. Moreover, its management and delivery have become complex and costly. Enhancing accountability, demonstrating impact and building support for the aid program will all be helped by much greater focus.

Build on success. The aid program has real achievements to its credit, but these are often invisible and little known. Our call is not primarily for a public relations offensive, though better documentation of success would help build support, and facilitate replication and scaling-up. More fundamentally, the aid program, recognizing the difficult environment within which it is operating and its very limited leverage, should strive to back winners: to help those doing a good job do more. As one interlocutor advised us: "Get back to focusing on success. Where things are functioning, provide resources."

Common purpose is key. Despite recent progress and agreements, expectations and objectives around the aid program are still at variance. While increased reporting and better dialogue will help, ultimately there has to be a meeting of minds, based on the resolution of long-standing disagreements, the recognition of shared interests across a wide range of issues, and the forging of common expectations for the aid program. We hope that our report helps provide the basis for this so that, over time, the aid program generates less irritation and becomes a stronger contributor to PNG's development, and to an increasingly multi-faceted and integrated relationship between Australia and Papua New Guinea, close neighbours and old friends.

Executive summary

1. Background

Papua New Guinea's development prospects are uncertain. Income per capita has stagnated since independence, and the country is off-track to achieve the Millennium Development Goals. The rapid economic growth and stable political environment and regulatory reforms of recent years hold promise, as does of course the massive LNG project now under construction. However, unless PNG is able to turn around the decline since independence in government effectiveness, rule of law, and control of corruption, it will find it difficult to rise to the two fundamental challenges facing the country: to create employment, and to convert government revenue from resources into public goods (roads, health, education) for the benefit of the majority. These same weaknesses in governance also mean that, as is widely acknowledged, the operating environment for aid in PNG is a difficult one.

Australia has been providing aid to PNG since 1975, but at levels that, adjusting for inflation, have fallen sharply over time. Though there has been a recovery in the latter half of this decade, on average, from 1975 to 2008, a real annual rate of reduction of 3% has been achieved. The long-term decline in aid volumes has been a deliberate policy endorsed by both governments, in an effort to wean PNG off Australian aid, and towards self-reliance. Aggregate aid to PNG is now below average levels for a country of its size and level of development. Australia remains the dominant donor, but there are signs that PNG is diversifying to other donors. Major shifts in the aid program include the shift from budget support to program aid (completed by 2002-03) and the growth in the last decade in aid for governance (from 20% of the aid program in 1999-00 to 36% in 2009-10).

Australian aid to PNG has a number of significant achievements to its credit. We were not called on to reach an overall verdict about the effectiveness of the Australian aid program, and we refrain from attempting one. We certainly think there are areas for improvement: these are detailed in the body of the report. But the fact that one of the main themes of our report is that the aid program should "build on success" clearly implies that we think that there are significant successes in the aid program.

2. Technical assistance (*"appropriate future balance in the use of different forms of aid, including training and technical assistance..."*)¹

The heavy reliance on technical assistance for capacity building in the Australian aid program to PNG is its most controversial aspect. Depending on how it is measured, technical assistance makes up about half of the aid program, perhaps more. The aid program employs about 360 technical assistance personnel. There have been technical assistance success stories, and, despite dissatisfaction with the

¹ These bracketed quotes are extracted from the Review's terms of reference, and indicate the topics in relation to which the Review was asked to provide analysis and recommendations.

reliance of the aid program on technical assistance, there is a strong demand for advisers from different parts of the Government of PNG. At the same time, several sources of evidence, from the decline in national governance indicators to a wealth of evaluation materials, and from international analysis as well, suggest that the “capacity building through advisers” model is not working.

Real change in this area is needed to improve aid effectiveness. A balanced approach is called for. On the one hand, further refinement of a capacity building model that has been discredited both internationally and within PNG will not suffice. On the other, it must be recognized that there will be ongoing demand and need for expertise to be financed by the aid program. Our recommendations are designed to signal a new approach, but not to abandon the use of the aid program to support better public sector management.

2. Technical assistance: summary of recommendations

- 2.1 Agree on a common, single definition to measure the volume of technical assistance (TA), and regularly monitor and report levels of TA support.
- 2.2 To reduce reliance on technical assistance, target the proportion spent on technical assistance to decline. Consider also setting sectoral targets, and introducing cost-sharing mechanisms.
- 2.3 Wherever possible, use existing technical assistance facilities to consider and process new TA requests.
- 2.4 Ensure that the primary line of reporting for all aid-funded personnel is to the PNG Government.
- 2.5 Target an extension of the average duration of hire of aid-funded personnel.
- 2.6 Reduce the focus of aid-funded positions on corporate processes, and increase that on implementation, including with positions outside of Port Moresby.
- 2.7 Give greater attention to cost-effectiveness, and adopt measures that will drive down the cost of technical assistance.
- 2.8 Most importantly, pilot the use of aid-funded in-line positions.

3. Sectoral focus (“mechanisms to progressively and substantially increase ODA investment in economic and social infrastructure in PNG”, “an appropriate role for Australia’s development cooperation program in relation to new and emerging issues”, and the balance between “capital investments and direct support for service delivery.”)

If the heavy reliance on technical assistance is the most remarked-on aspect of the aid program, the thin spread of the program is the second. Many stakeholders raised this issue, and gave it as a reason for the apparent lack of impact of Australia’s aid. And, indeed, it is difficult to find an area of important government activity in PNG where the Australian aid program is not somehow engaged. In addition, within some sectors the aid program appears to be highly fragmented.

Increasing focus is a difficult challenge. Given Australia’s dominant aid position in PNG, and the Partnership for Development, which commits to aid activity in eight sectors, it is hard to envisage the aid program greatly narrowing its sectoral coverage. And the aid program does need to remain responsive and open to new challenges. At the same time, selectivity is an important and internationally accepted principle of aid effectiveness. Its greater application in PNG would improve the accountability of the aid program, reduce transaction costs, and help address the perception that the aid program is not having an impact. The use of flagship sectors, which would be the biggest recipients of aid, and receive the

greatest attention from both Governments, would give the aid program a core and coherence it currently lacks. Streamlining of aid activities within sectors would also help.

Greater focus by the aid program on both transport infrastructure and the education sector (defined broadly to include secondary, technical and tertiary education) would respond to the felt need expressed by many stakeholders to use the aid program more purposively to boost PNG growth prospects. However, the potential to expand road maintenance funding is limited by severe absorptive capacity constraints in the infrastructure sector which are already making it impossible to spend allocated funds, and which will likely worsen in coming years with the LNG project. Absorptive constraints seem less severe in the education sector (broadly defined). We suggest education become the flagship sector for the Australian aid program to PNG, and map out, with illustrative figures, the potential for funding for education to constitute half of Australian aid to PNG.

Given the historic and persistent underfunding of recurrent expenditure in PNG, and the high returns attached to closing recurrent funding gaps, prioritization by the aid program of recurrent expenditures (including road maintenance) is warranted, and closer links between the aid program and the recurrent budget should be sought.

3. Sectoral focus: summary of recommendations

- 3.1 *Greater selectivity and focus in what has and will remain a wide-ranging program could be achieved both by identification of a flagship sector or sectors which would receive the largest share of funding and attention, and by simplification of aid program activity within each aid-funded sector as well.*
- 3.2 *We recommend that education (defined broadly to include secondary, technical and tertiary education so as to strengthen the felt need expressed by many stakeholders to use the aid program more purposively to boost PNG growth prospects) become the flagship sector for the Australian aid program to PNG.*
- 3.3 *Prioritization by the aid program of recurrent expenditures (including road maintenance) is warranted, and closer links between the aid program and the recurrent budget should be sought.*

4. Support to lower levels of government (“an appropriate balance between assistance to the national government and to provinces, districts and local level governments.”)

There is widespread support for the work of the aid program with the provinces, though again a problem of thin spread. We perceive a high level of risk from working directly with lower-level governments, except through the provinces. Facility grants have a good track record and should be used more broadly.

4. Support to lower levels of government: summary of recommendations

- 4.1 *The aid program should continue its support for provincial reform, though we suggest a focus on provincial reform in a smaller number of provinces demonstrably committed to service-delivery improvement.*
- 4.2 *Direct engagement by the aid program at the District or LLG level (circumventing provincial administrations) would carry substantial risk, and should not be proceeded with.*
- 4.3 *Direct payments to the (health or education) facility level are likely to increase transparency and reduce leakage. They are already used in the education sector, and should be trialled in health.*

5. Alignment (*“any additional measures to ensure that Australian aid is aligned with and supports PNG budget priorities, promotes fiscal sustainability, and is reflected in PNG budget documentation.”*)

Reporting of Australian aid on the PNG budget is comprehensive, and the focus on recurrent spending promotes fiscal sustainability. Alignment of the Australian aid program with PNG budget priorities is a fundamental requirement of aid effectiveness. Its achievement would ensure that greater aid funding does not lead to reduced domestic funding of development priorities, except by mutual agreement. However, although repeated attempts to forge a tight link between aid and PNG Government spending have been made, they have not been sustained. The Australia-PNG Partnership for Development is a useful initiative, one which will help promote alignment and mutual accountability. However, the performance benchmarks in the Partnership schedules for transport infrastructure and basic education are undermined by large funding gaps. A multi-year expenditure framework is needed. This would indicate how funds would be allocated to major sectors in the coming years, and would provide a basis for setting realistic sectoral performance targets. It would pull together both development and recurrent expenditures of the PNG Government, and include aid commitments from donor partners.

5. Alignment: summary of recommendations

- 5.1 *The 2011-2015 Medium Term Development Plan will be a crucial document for alignment of the aid program with PNG priorities, and we recommend that its preparation include consultation with donors.*
- 5.2 *The Partnership for Development schedules have the potential to improve alignment between aid and the PNG budget, provided funding commitments are adhered to, and the large funding gaps closed.*
- 5.3 *To close the large funding gaps in the Partnership for Development schedules, and to promote the alignment of aid and budget funds under common development priorities, we recommend that the PNG Government develop a multi-year expenditure framework (MTEF). This would indicate how both development and recurrent, government and aid funds would be utilized to fill critical recurrent funding gaps and achieve realistic priority sectoral performance targets. Major Partnership for Development schedules would be revised once the MTEF is in place.*

6. Delivery mechanisms (*“appropriate mechanisms for the delivery of Australian ODA, including the local and international private sector, volunteers, civil society and government-to-government programs.”*)

There are important non-state actors in PNG which are making effective use of aid funding. In line with the general theme of the report of building on success, there is more the aid program could do to work with non-state actors. In particular, the aid program can help PNG make more use of church delivery systems in the health sector. We also recommend an expanded volunteer and NGO program, and note the strong support for on-going government-to-government programs.

6. Delivery mechanisms: summary of recommendations

6. Where non-state actors are performing effectively and/or showing potential, they should receive increased support. Mechanisms to do this include:
 - 6.1 A major initiative in the health sector to explore ways the aid program can assist the PNG Government to achieve its aim of delivering a greater proportion of health services through better-performing church-run facilities.
 - 6.2 Consider providing the Incentive Fund with the means to provide flexible and long term support to strong institutions outside of government beyond the provision of capital funds.
 - 6.3 An Enterprise Challenge Fund to provide cost sharing for private sector projects which are innovative and pro-poor (subject to success under the existing regional pilot).
 - 6.4 A scaled up volunteer and NGO program.

7. Sector-wide approaches (SWAPs) (“measures to improve the effectiveness of sector-wide approaches [SWAPs] including possible alternatives.”)

The aid program needs to deliver to the sectors which it supports not only funding but also management capacity, innovation and, most importantly, a capacity to demonstrate results. There are a range of approaches to collaboration and alignment across the sectors where the aid program is active. Our consultations made clear that there are still important issues of government leadership, coordination and accountability to be addressed moving forward. However, there is also a track-record that can be built on. While the aid program has stopped short of providing funds, earmarked or otherwise, into the PNG budget, considerable progress has been made in realizing the goal of joint implementation of the aid program. While the sectoral interventions all differ in various ways, they are often referred to as SWAPs (sector-wide approaches) and certainly by international standards all have some SWAP characteristics. The SWAP approach is a natural one for providing support for core service-delivery areas, which lend themselves to sectoral programs rather than discrete projects. However, duplication can be a problem. This is not a problem for roads or the justice sector (where only national agencies are involved) but it is a growing issue in the social sectors, where aid funding to provinces increasingly duplicates national funding for the same sectors.

The aid program needs to move in either of two directions. One would be to integrate with budget funding, for example through the provincial function grants. The other would be to step back from providing dispersed sectoral support, and take over responsibility for a particular service delivery area, for example, provision of text books or drugs. The advantage of the integrated approach is that it would help improve the accountability and effectiveness of GoPNG spending. We recommend that it be pursued in the first instance, but note that it will be demanding for both sides. On the Australian side, it would require giving up the ban on providing funds, even if earmarked, into the PNG budget. The associated fiduciary risks can be managed through strengthened financial reporting and supervision. More generally, negotiations between the two governments would allow a range of issues including fiduciary risk to be openly addressed and managed to the satisfaction of both parties. On the PNG side, replacing parallel by integrated systems in the social sectors would mean allowing aid money to flow to the recurrent rather than the development budget.

7. Sector-wide approaches: summary of recommendations

- 7.1 A programmatic approach is appropriate for providing support to core areas of service delivery, and should be persevered with. The problems that have arisen (and that will continue to arise) need to be resolved on a sector-by-sector basis. A pragmatic approach is needed: there is no one size which fits all sectors.
- 7.2 We suggest a review of administrative arrangements in the law and justice (L&J) sector for the allocation of aid and support the review underway of the size and role of the L&J Secretariat.
- 7.3 There is a risk in the primary health and school education sectors of the aid program creating parallel uncoordinated and duplicative systems for provincial and facility recurrent funding. We support reforms which would lead to the greater integration of aid and budget funds, and therefore greater impact, for example through aid funding of provincial function grants. Open dialogue and negotiations would be needed to resolve several outstanding issues, including the management of fiduciary risk. Failing successful resolution of these issues, the aid program should consider taking on discrete service delivery tasks within key sectors.
- 7.4 In the case of the transport sector, the aid program may need to take a more "hands-on" approach to ensure that current capacity constraints which are blocking the expenditure of allocated funds are relieved.

8. Development Cooperation Treaty ("any necessary changes to the goals and objectives of the Development Cooperation Treaty to ensure Australia's aid has high development impact and is increasing in the priority areas of the PNG-Australia Partnership for Development, namely transport infrastructure, basic education, health, economic and public sector management, statistics, HIV/AIDS, higher education and law and justice.")

The Review found that most of the wide-ranging changes to the aid program put forward in response to its terms of reference do not touch on the specific provisions of the Development Cooperation Treaty (DCT). The distinctive principles embedded in the Development Cooperation Treaty are sound (multi-year indicative commitments, performance benchmarks) and consistent with international (Paris/Accra) agreements. However, the Partnership for Development schedules need to be formally adopted as Treaty performance benchmarks, and adherence to the Treaty would require a return to the provision of multi-year indicative funding commitments. The issues raised by the Government of PNG in relation to taxation of companies involved in delivering the aid program require review before a final decision can be made on the revision of the DCT or any successor agreement. To reflect the maturity and multi-faceted nature of the PNG-Australia relationship, and the increasing role of trade and investment within that relationship, and to promote the goal of economic integration, consideration should be given to replacing the Development Cooperation Treaty by an Economic Cooperation Treaty.

8. Development Cooperation Treaty: summary of recommendations

- 8.1 To update the DCT and ensure adherence, adopt the Partnership for Development schedules as Treaty performance benchmarks, and return to the provision of multi-year indicative funding commitments by Australia.
- 8.2 Review and resolve the issues raised by the Government of PNG in relation to taxation of companies involved in delivering the aid program before a final decision is made on the revision of the DCT or any successor agreement.
- 8.3 Consider replacing the Development Cooperation Treaty by an Economic Cooperation Treaty.

9. Exit strategy (“a realistic strategy and timeframe for PNG’s progressive graduation from Australian official development assistance, and the actions required of both governments to achieve this. The strategy will give effect to the GoPNG’s decision to gradually reduce development assistance to mutually agreed levels in future.”)

The Government of PNG has stated that it is pursuing an aid exit strategy as a political objective in order that the country can be responsible for its own destiny and development rather than continue to rely on foreign aid. It is supportive of a gradual implementation of the strategy over an agreed period of time. Our own analysis shows that PNG has already significantly reduced its reliance on total and Australian aid, and that, unlike at independence, trade is today much more important than aid in the PNG-Australia relationship. Our analysis also confirms that correct phasing will indeed be crucial to the success of any aid exit strategy. It is possible that PNG will face a difficult budgetary situation in the coming years prior to the commencement of LNG tax revenues which, we were informed, will not be till around 2018. Moreover, aid supplements not just internal financial resources but technical expertise and capacity which are going to be in high demand in the coming years. For these reasons, the Australian aid program has an especially important role to play in the run-up to the LNG project. Moreover, the substantial reduction in aid reliance already achieved to date gives PNG the space to accommodate a temporary increase in the aid program, which Australia has indicated it is willing to finance.

Longer term, PNG should target a falling ratio of aid to revenue over time. This would be consistent with PNG’s goal of an exit strategy, and with obtaining more control over its development destiny. Any target should be reviewed periodically, say, every three or five years. Graduation should be grounded in success. Continued adherence to aid reduction targets should be dependent on PNG sustaining good economic growth, and making progress on human development indicators.

9. Exit strategy: summary of recommendations

9. To implement its exit strategy, PNG should target a falling ratio of aid to revenue over time (for example, to reduce Australian aid to below 10% of revenue by 2020) dependent on benchmarks relating to growth and the MDGs being achieved. However, a phased approach is needed. The substantial reduction in aid reliance already achieved to date gives PNG the space to accommodate a temporary increase in the aid program, particularly up to the commencement of significant LNG revenues in around 2018, and before which PNG’s budgetary situation could be difficult.

10. Transparency and accountability (“appropriate measures including regular reporting and exchange of information to improve transparency and accountability for results from development expenditure in PNG.”)

Developing mechanisms to improve reporting, transparency and accountability are critical for any effort to improve aid effectiveness. A regular and sustained dialogue at both the bureaucratic and political level is needed to support an effective aid program. Realistic expectations about what the aid program can achieve are also key.

10. Transparency and accountability: summary of recommendations

Recommendations for both Governments:

- 10.1 *The Partnership for Development schedules promote accountability, though their funding gaps need to be filled (see Section 5).*
- 10.2 *Lower-level, intermediate goals, which the aid program can be realistically expected to influence, are also needed for the aid program.*
- 10.3 *Aid program activities should embed and thereby model principles of public transparency and accountability.*
- 10.4 *Reporting expectations and modes need to be adjusted to take account of the greater use by the aid program of GoPNG systems. Stand-alone reporting by AusAID to the National Department of Planning and Monitoring is less relevant in such a context.*
- 10.5 *Both Governments could do more to publicize the success stories of the aid program.*
- 10.6 *A small consultative council advising both Governments in relation to the Australian aid program to PNG could be a useful and practical transparency and accountability mechanism.*
- 10.7 *Make this Review public.*

Recommendations for the Government of Papua New Guinea:

- 10.8 *Strengthened government leadership and coordination of the aid program by the PNG Government is critical for improved aid effectiveness. In particular, the Department of National Planning and Monitoring should avoid assuming management responsibilities for sectoral projects and programs and focus its efforts on providing strategic guidance and oversight to the aid program.*
- 10.9 *Annual meetings with donors to promote effective dialogue and address aid effectiveness issues deserve priority attention.*

Recommendations for the Government of Australia:

- 10.10 *Greater use of monitoring and evaluation, extending beyond audit, would enable AusAID to establish not only that funds have not been misused, but that they have been used effectively, and provide a stronger evidence base for policy dialogue.*
- 10.11 *AusAID could make much more data about its PNG aid program available on its website.*
- 10.12 *A more transparent and shared approach to the question of which AusAID staff are charged to the aid program is warranted.*

Section 1. Background

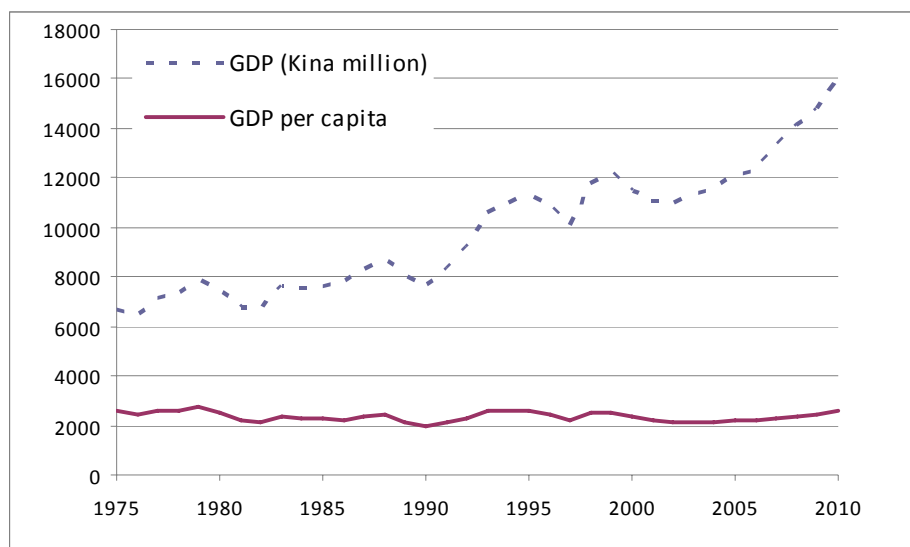
1.1 Economic and social development in Papua New Guinea

Though rich in resources, PNG faces many development challenges. PNG has large arable tracts of land, is rich in mineral, forestry and fishing resources, and has a high tourism potential. PNG's challenges include high levels of ethnic diversity (with some 850 languages), and high transport costs (the two main urban centres are divided by a huge mountain range and are not connected by road). Both the nation state and the modern trading economy are recent arrivals to Papua New Guinea.

PNG's GDP per capita has stagnated since independence, but the economy has grown robustly over the last decade. While the long-term record is one of stagnation (Figure 1), the record over the last decade is much more positive (Figure 2). Growth in PNG in recent years reflects the resources boom and the impact of high commodity prices, which in turn has fuelled a construction boom, and growth in other sectors. Telecom liberalization which has led to rapid mobile penetration is another very positive recent development.

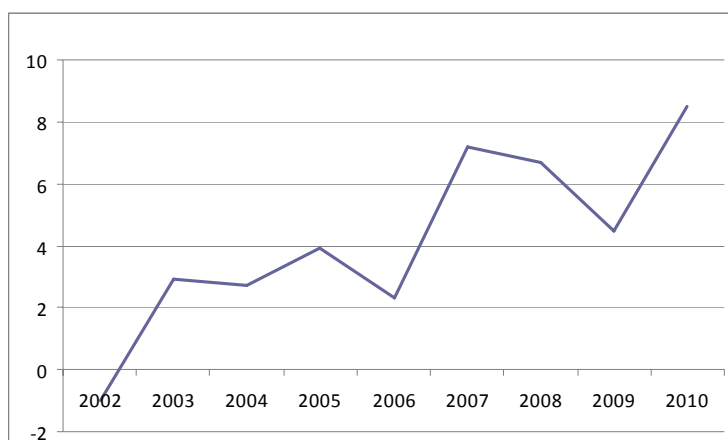
Short-term growth prospects are unclear. PNG Treasury reflects growth falling back to 2% by 2013, prior to the commencement of the LNG project. However, to some observers, this is too pessimistic an outlook, and growth in PNG should remain high as long as commodity prices do.

Figure 1 GDP and GDP per capita in PNG since independence (measured in 2000 prices)



Source: Adapted from Batten (2009) and PNG Budget Documents (various years).

Figure 2 Economic growth in PNG this decade (percentage GDP growth in constant prices)



Source: PNG Budget Documents (various years).

Note: 2010 figures are projections.

Human development indicators are poor in PNG, which is off-track in relation to most of the Millennium Development Goals (MDGs).² Some indicators do show improvement. Under-5 child mortality has fallen from 94 per 1,000 live births in 1996 to 75 in 2006. Basic education indicators have also improved in recent years. Net enrolment ratios up to Grade 8 increased from 51% in 2007 to 61% in 2009 for girls and from 54% to 66% for boys. The completion rate to Grade 8 for boys and girls combined has increased from 42% in 2006 to 57% in 2009 (AusAID, 2009b). However, social indicators for women are particularly low (maternal mortality rates are very high, there are high levels of violence against women, and there is only one female MP), there is a generalized HIV/AIDS infection (with infection rates increasing by about 0.5 percentage points a year), and levels of TB and malaria are high. The percentage of people living in poverty is estimated to have risen from 24% in 1996 to 40% in 2002. PNG's *Vision 2050* notes that "PNG's global Human Development Indicators (HDI) ranking dropped from 128 out of 175 countries in 1994 to 145 out of 179 countries in 2005. This reflects our worsening social indicators and marked improvements in other countries' socioeconomic indicators." (2009, p. 17). A recent donor report notes the "...emerging consensus in Papua New Guinea ... that human development outcomes are far less than satisfactory and that service provision in many parts of the country is collapsing" (World Bank, ADB, AusAID, 2007, p.1).

PNG's development prospects depend critically on the quality of its public institutions. PNG's formal sector is small, and its growth resource-intensive. Some 85% of the population live in rural areas following a largely subsistence lifestyle. Prospects for the majority in PNG depend on: (a) the extent to which the public sector is able to convert government revenues from the resources sector into public goods (such as health, education, roads) for the benefit of the largely rural population; and (b) employment generation through growth in the labour-intensive and service sectors of the economy, such as agriculture, mobile telephony, and tourism. Given the resources boom, and the LNG project in

² Statistics in this paragraph from AusAID (2009a) unless otherwise noted.

particular (which will eventually generate annual revenue for government considerably in excess of one billion Kina), the quality of governance is going to become more rather than less important for PNG.

Some aspects of governance have clearly improved in PNG. After a decade of acute instability in the 1990s, PNG is now an established democracy, experiencing a period of relative political stability: the current Prime Minister Sir Michael Somare is now in his eighth consecutive year of office. Macroeconomic stability has also improved dramatically over the decade, though in the last couple of years government spending has expanded rapidly and inflation has increased. While PNG continues to score badly on the international “cost of doing business” index, the regulatory environment has improved in certain important regards. PNG has benefited from the privatization of the Papua New Guinea Banking Corporation in 2001, and of Nambawan Super, the public-sector superannuation fund. The PNG economy and population have also gained from the liberalization of mobile telephony, and competition on international air routes. Indeed, the private sector would appear to be stronger than ever in PNG. The country also has very strong churches that, with government funding, run about half of the country’s health and education systems.

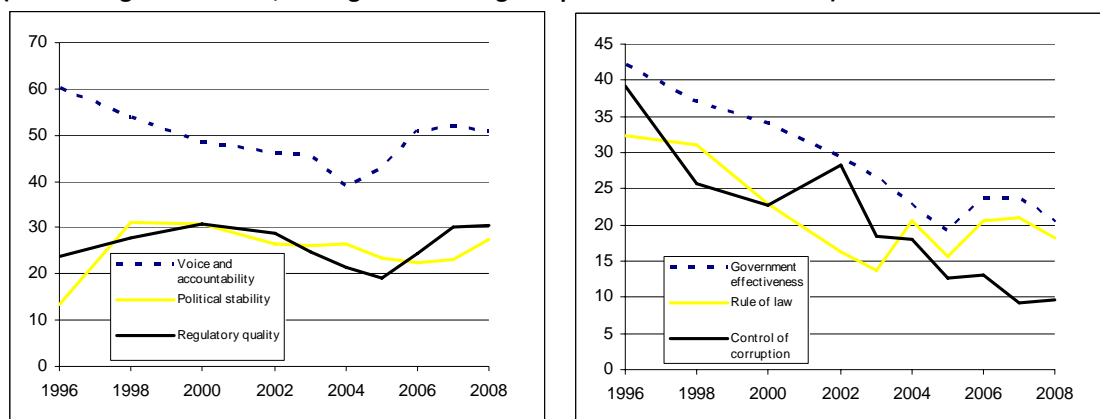
In other areas, PNG faces serious and worsening problems of governance. There is a widespread perception that corruption is serious and on the increase, and that public sector capacity is weak and declining. Deep, and in some quarters growing, concerns are voiced about the law and order situation, which is a problem not only in Port Moresby, but in some other urban centres and some rural areas.

PNG’s differential performance over a range of governance dimensions is confirmed by the World Bank’s governance indicators. The World Bank has developed a range of governance indicators which capture performance since 1996 over multiple dimensions of governance using a variety of data sources for a large number of countries (212 in total). These indicators suggest that PNG’s performance is stable and/or improving in relation to indicators for voice and accountability, political stability and regulatory quality (Figure 3a). For these indicators, PNG is in the bottom third to half of all countries. But PNG’s performance in relation to corruption, government effectiveness, and the rule of law is low and deteriorating (Figure 3b). On control of corruption, PNG’s ranking is now in the bottom 10% of countries covered; on government effectiveness and the rule of law it is in the bottom 20%.

Figure 3 PNG's score (percentile ranking) for a range of governance indicators:

- (a) where performance is stable or improving: political stability, voice and accountability and regulatory quality;
- (b) where performance is weak and deteriorating: control of corruption, government effectiveness, and rule of law.

(NB: The higher the score, the higher the rating compared to other countries.)



Source: Kaufmann, Kraay, Mastruzzi (2009).

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations.

Overall, PNG's development prospects are uncertain. On the one hand, good economic growth, a stable political environment, and recent regulatory reforms bode well for the country, as does the improved macroeconomic performance, provided it can be sustained. On the other, unless PNG is able to turn around the decline in government effectiveness, rule of law, and control of corruption, it will find it difficult to rise to the two fundamental challenges noted earlier: to expand employment, and to convert resource revenue into public goods for the benefit of the majority.

The same weaknesses in governance make the operating environment for aid in PNG difficult. This was commented on by all development partners and NGOs, and is acknowledged by many in the PNG Government as well.

PNG's development policies have been guided in recent years by the Medium Term Development Strategy, 2006-2010. The MTDS is based on Papua New Guinea's Program for Recovery and Development and is built around three objectives: good governance; export-driven economic growth; and rural development, poverty reduction and empowerment through human resource development. The MTDS identifies seven core sectoral expenditure priorities: transport infrastructure maintenance; promotion of income earning opportunities; basic education; adult learning; primary health care; HIV/AIDS prevention; and law and justice.

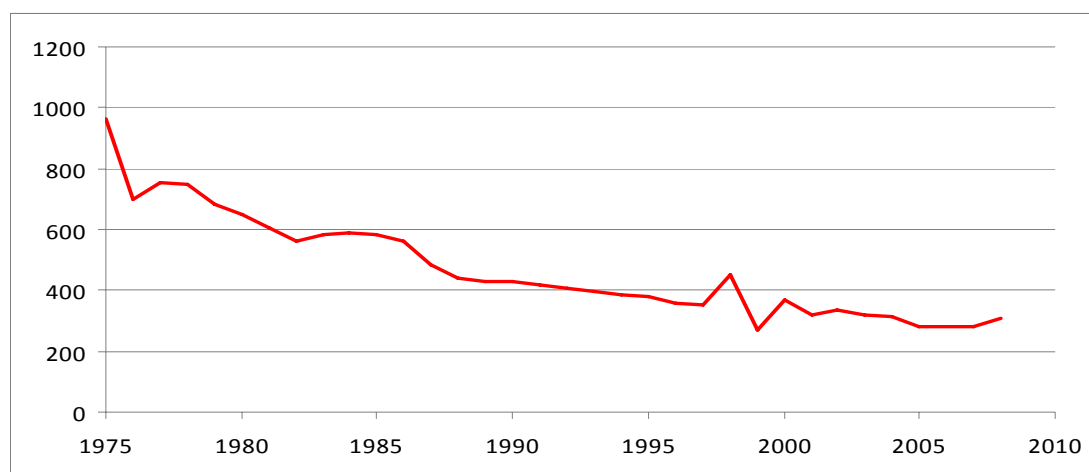
Recently released long-term strategic documents set out ambitious goals, targets and strategies. The Papua New Guinea Vision 2050 has the overall aim of PNG being ranked in the top 50 countries in the

Human Development Index by 2050. It is underpinned by seven pillars: human capital development, gender, youth and people empowerment; wealth creation; institutional development and service delivery; security and international relations; environmental sustainability and climate change; spiritual, cultural and community development; and strategic planning, integration and control. The *Papua New Guinea Development Strategic Plan 2010-2030* sets out objectives and strategies to be implemented by the next four 5-year plans with the overall aim of PNG becoming a middle-income country by 2030, and being on track to meet *Vision 2050* targets. The seven core objectives of the Development Strategic Plan relate to: strategic planning; systems and institutions; human development; wealth creation; security and international relations; environment and climate change; and partnership with churches for integral human development.

1.2 Australian aid to PNG

Australia has been providing aid to PNG since 1975, but at levels that have fallen significantly over time. Adjusting for inflation, aid volumes from Australia to PNG have fallen sharply since independence (Figure 4), though there has been a recovery in the latter half of this decade (Figure 5). The long-term decline in aid volumes has been a deliberate policy endorsed by both Governments, in an effort to wean PNG off Australian aid, and towards self-reliance. In the mid 1980s, a target of an annual rate of reduction of 3% in real terms was endorsed by both Governments (AusAID, 2003). And, in fact, on average from 1975 to 2008 a real annual rate of reduction of 3% has been achieved.

Figure 4 Australian aid to PNG since 1975 (USD millions, in 2007 prices)

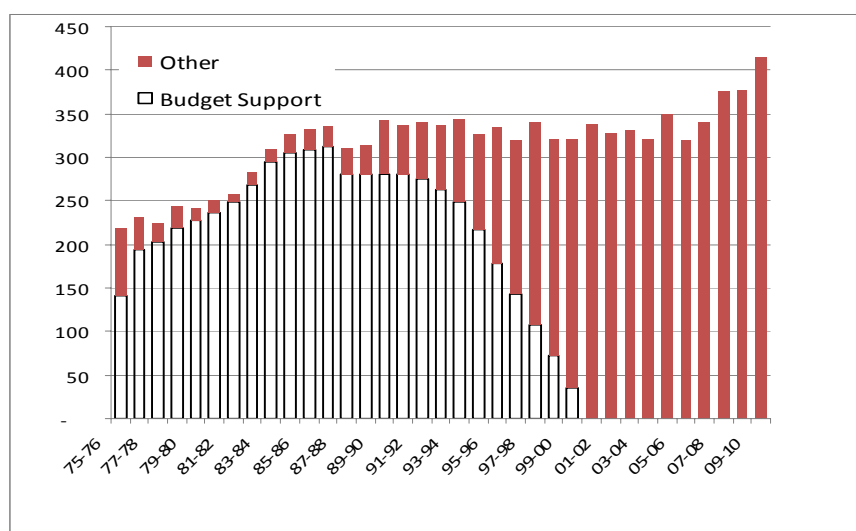


Source: OECD DAC.

For the first half of PNG's independence Australia gave aid as budget support, but over the course of the 1990s budget support was converted to program support. The first Development Cooperation Treaty (DCT) between Australia and PNG signed in 1989 agreed that budget support would be progressively replaced by program aid. This process commenced in 1992-93, and was completed by 2002-03 (Figure 5). As the 1997 Simons Review of the Australian aid program noted: "The common reason for supporting the shift to program aid is a belief that budget support was not well used and that programmed

Australian aid can be more effective in the restoration of services and the building of capacity” (1997, p. 102). From the start, the aim was to move from budget support to “jointly programmed” aid, to use the words of the 1989 DCT. Jointly programmed aid could take the form of projects, but was intended to be not only agreed on but implemented in partnership between the two Governments. Considerable progress has been made in translating the ideal of program aid into a reality, as Section 8 documents. But whether program aid has delivered is a matter of considerable debate.

Figure 5 Australian aid to PNG since independence: from budget support to program aid (\$ million)

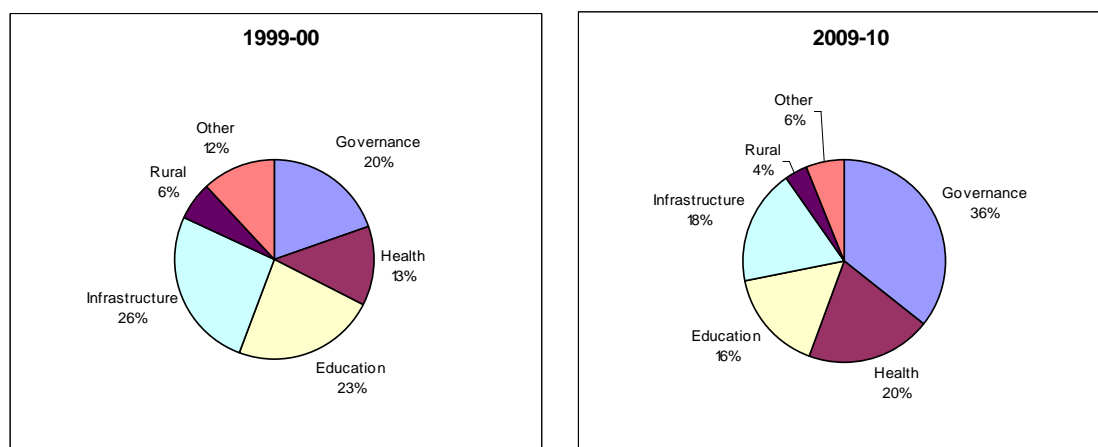


Source: AusAID statistics and AusAID (2003).

Education, health and infrastructure have long been important sectors for Australian aid. In the last decade, governance has become an increasingly important area. Over the period 1975 to 2002, 27% of Australia’s aid went to education, 24% to infrastructure, 12% to health, and 21% to governance (AusAID, 2003). As Figure 6 shows, the main change over the last decade has been in the area of governance, where the share of total aid spending almost doubled from 20% in 1999-00 to 36% in 2009-10.³ Health has increased its share of the aid program (thanks to new HIV/AIDS spending), but education and infrastructure have both seen a significant decline.

³ Governance aid largely goes to central agencies (such as Treasury) and agencies with responsibility for law and justice, and for elections. Some governance aid supports non-government agencies which promote demand for good governance. Governance aid can go to both national and provincial governments.

Figure 6 Changes in the sectoral distribution of Australian aid over the last decade



Source: Own calculations based on data from AusAID.

This shift is consistent with the rise in importance given by Australia to governance in its global aid program over this period. The share of spending on governance in the global Australian aid program increased from 9% in 1996-97 to 36% in 2005-06 (Duncan, Howes and Williams, 2005, p.14).

The Enhanced Cooperation Program was one of the major innovations in the aid program over the last decade. The share of spending on governance in the aid program to PNG could have increased much more. In 2004, the Enhanced Cooperation Program was launched. This envisaged the provision of some 60 Australian government officials to work in economic management and legal and judicial areas of the PNG government, and some 210 Australian Federal Police (DFAT, 2004, p. 22). An additional \$805 million was to be provided over four years to cover the cost of the police. However, PNG's Supreme Court ruled that some of the provisions contained in the Enhanced Cooperation Treaty (see below) were unconstitutional, and on this basis Australia withdrew the offer of police personnel under the ECP, and with it the additional funding. However, assistance to economic and legal/judicial areas of government from a range of Australian government departments continues under the ECP, now renamed the Strongim Gavman (Strengthening Government) Program. ECP (now SGP) assistance is \$33 million in 2009-10. The increased emphasis in PNG on 'whole of government' support is again consistent with trends across the Australian aid program, where departments other than AusAID have come to play an increasingly important role in the delivery of the Australian aid program. This in turn is consistent with international practice in relation to aid to so-called 'fragile states.'

The Australian aid program is governed by the Development Cooperation Treaty of 1999 as well as by the Joint Agreement on Enhanced Cooperation of 2004. The first Development Cooperation Treaty between PNG and Australia, signed in 1989, agreed on the transition from budget support to jointly programmed aid, and on the provision of five years of forward estimates of aid support to PNG. A second Development Cooperation Treaty was signed in 1999. It removed reference to the provision of aid through budget support, but still provided for stability through the provision of 5-year indicative forward estimates for aid. The Treaty also for the first time included benchmarks, performance against

which was to “influence the level and allocation of funding of the development cooperation program.”⁴ The Joint Agreement on Enhanced Cooperation Between PNG and Australia of 2004 set out the terms under which Australian police and other government officials would provide support to the Government of PNG.

*A country strategy for Australian aid to PNG was put in place in 2006, for the period to 2010.*⁵ This strategy included no resource envelope for aid to PNG, but listed four priority areas: improved governance and nation building; sustainable broad-based economic growth and increased productivity; improved service delivery and stability; and a strengthened, coordinated and effective response to the HIV/AIDS epidemic.

The PNG-Australia Partnership for Development signed in August 2008 by the two Prime Ministers has effectively superseded the old country strategy. The Partnership approach was foreshadowed in the Port Moresby Declaration, also co-signed by the Prime Ministers of Australia and PNG, in March 2008, which committed Australia to work with the Pacific Islands to achieve the MDGs through Partnerships for Development in a spirit of mutual respect, responsibility, and accountability. The partnership with PNG was one of the first: at the time of writing, some eight partnerships with Pacific Island countries have now been signed. The Partnership committed the Government of Australia to “make long term, predictable and increased commitments of development assistance, affirmed on an annual basis, taking into account performance against Partnership commitments, targets and performance.” Five priority areas or schedules were agreed to under the Partnership at the June 2009 Ministerial Forum: for transport infrastructure, basic education, health, public service, and statistics. Two of these include multi-year funding commitments from both Australia and PNG (transport infrastructure and basic education). At the 2009 Ministerial Forum, it was agreed another three schedules would be prepared and agreed on, for law and justice, HIV/AIDS and higher education. These eight schedules together would cover some 80% of the aid program.

Australia and PNG have also entered into a Joint Understanding in relation to cooperation over the LNG project. Australia’s Export Finance and Insurance Corporation is providing a loan of up to \$500 million to the sponsors of the LNG project. Through agreements reached in the context of that loan, and at the 2009 PNG Ministerial Forum, Australia and PNG have agreed to collaborate on the establishment of a sovereign fund to manage Government of PNG LNG revenues, and Australia has agreed to provide training and other targeted assistance to address capacity constraints which might hinder the LNG project.

⁴ As discussed in Section 5, performance benchmarks were first introduced into the aid program in 1995. They did not, however, appear in the 1989 Treaty.

⁵ The 2004 Review notes the existence of a 200-2003 strategy. There was also a 2002 framework http://www.aisaid.gov.au/publications/pdf/png_framework.pdf. At the time of the last Review, there were plans to develop a joint country strategy between AusAID, the World Bank and the ADB but this did not eventuate due to GoPNG objections.

Both Australia and PNG have given considerable emphasis to the implementation of the international Paris and Accra agreements on aid effectiveness. The PNG Commitment on Aid Effectiveness signed in July 2008 by PNG and many of its development partners, including Australia, commits to the implementation of the international principles of ownership, alignment, harmonization, managing for results, and mutual accountability embodied in the 2005 Paris Declaration and 2008 Accra Agenda for Action. The Cairns Compact on Strengthening Development Cooperation in the Pacific (August 2009), signed by all Pacific Island Forum members, is written in the same spirit.

Aggregate aid to PNG is now below average levels for a country of PNG's size and level of development. Table 1 illustrates with comparisons to other countries. More formal regression analysis confirms that a "typical" country of PNG's size and income level would receive more than twice as much aid as PNG in fact does. The average small (with a population of 10 million or less), poor (with per capita income in PPP terms of \$US10,000 or less) African country receives 10% of its GDP in aid, compared to only 5% for PNG.

Table 1 Aid volumes to PNG in comparative perspective (2008)

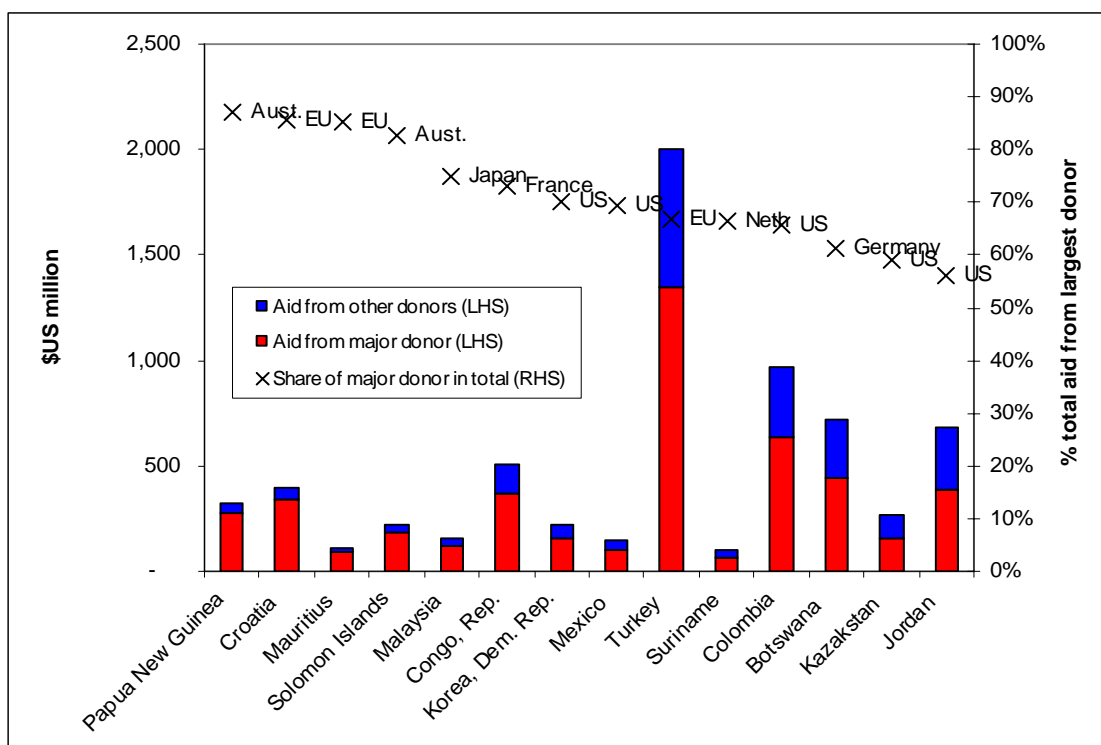
	Aid/GDP	Aid per capita (USD)	GNI pc (USD)	Population (millions)
Papua New Guinea	5.1%	50	1870	6.3
Benin	8.7%	56	1410	8.4
Uganda	14.5%	56	1050	30.6
Mozambique	22.2%	83	730	21.4
Eritrea	11.3%	32	620	4.8
Cambodia	8.0%	46	1720	14.4
Laos	9.2%	65	1920	6.1
Vietnam	3.6%	29	2530	85.2

Source: Own calculations from World Development Indicators.

Note: Aid and GDP are measured in current \$US. GNI (Gross National Income) is measured in \$US but using purchasing power parities rather than market exchange rates.

Australia remains the dominant donor. There are very few countries where a single bilateral donor is so important relative to others. The OECD DAC reports the ratio of Australian to total aid at above 80%. As Figure 7 shows, this is the highest ratio for a single donor to total aid for any country with a substantial aid program (not including colonies, and considering aid programs in excess of \$100 million).

Figure 7 Total aid and share of largest donor for countries with a dominant donor



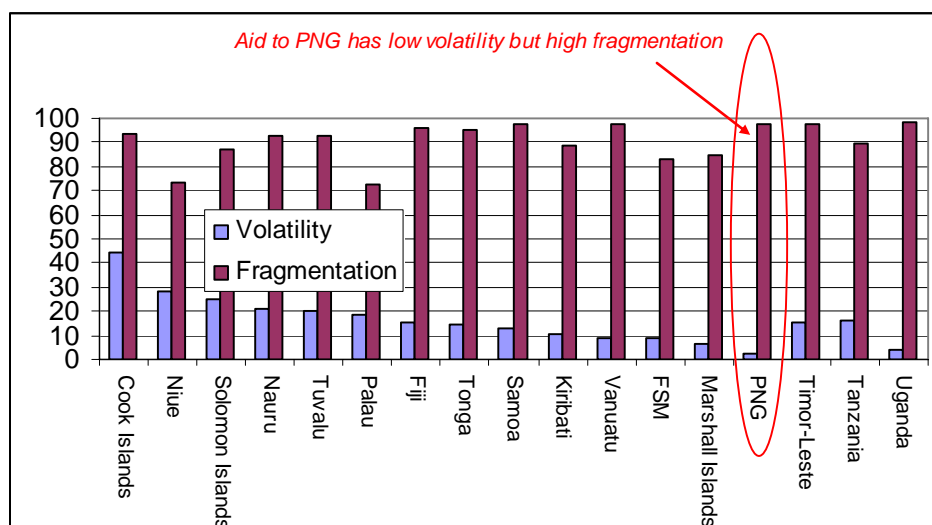
Source: OECD DAC.

Notes: The year is 2008, except for PNG which is 2007. Data for 2008 is atypical for PNG due to large negative aid flows from Japan. Countries covered are those with an aid program above \$US100 million, excluding colonies, and where a single donor is responsible for at least half of all aid flows.

There are signs that PNG is diversifying to other donors. 2010 PNG budget documents put Australian aid at 68% of the total. China has started providing aid. The Asian Development Bank has scaled up lending. The Global Fund is expanding in PNG through funding of a large malaria program, and will soon become PNG's biggest donor in the health sector. The World Bank, after a difficult period, has re-engaged with PNG under a new country assistance strategy.

Aid to PNG is very stable, but fragmented. The dominance of a single donor, and the provision of regular annual funding by that donor means that aid to PNG is less volatile than aid to most other aid recipients (Figure 8). However, Australia's dominance as a donor does not result in less fragmented aid than occurs in other countries with far more and more dispersed donors (Figure 8). (Fragmentation measures the extent to which aid is divided up into individual activities: the more these are, and the smaller their value, the greater the fragmentation.) This reflects the thin spread of Australian aid, within and between many sectors and activities, a point we return to later in the report.

Figure 8 Volatility and fragmentation of aid to PNG compared with other Pacific and developing countries



Source: Adapted from AusAID (2009a).

Note: Volatility measures the extent to which volumes of aid vary from year to year. Fragmentation measures the extent to which aid is divided up among a number of small activities. Both variables are measured as indices on a scale of 0-100, with a higher score indicating higher volatility and higher fragmentation, respectively.

The Australian aid program has a number of significant achievements to its credit. We were not called on to reach an overall verdict about the effectiveness of the Australian aid program, and we refrain from attempting one. We certainly think there are areas for improvement: these are detailed in the remainder of the report. But the fact that one of the main themes of our report is that the aid program should “build on success” clearly implies that we think that there are significant successes in the aid program. They include the following:

- **Road maintenance** The aid program has helped shore up maintenance for PNG’s most important roads. The share of national roads in a good condition, though still less than 30%, has risen steadily over the last few years, The contribution of the aid program to this progress has been substantial. In 2009, the aid program financed the maintenance of 2,000 km of national roads.
- **Health** The multi-donor trust fund, the Health Sector Improvement Program (HSIP), established by the Australian aid program, is providing non-salary recurrent funding to primary health care on a scale roughly equal to that provided by the central government (NEFC, 2009). In particular, donor funding is the main funding source for health mobile patrols (DPLGA, 2009), which are critical in a population as dispersed as PNG’s. The aid program has also spearheaded the drive against HIV/AIDS, promoting awareness and testing: 120,000 people accessed testing and counselling in 2008. The HIV/AIDS epidemic is not yet under control, but it is hard to imagine that the situation would not be much worse without this strong intervention. The aid program also provides critical support to the training of PNG’s doctors, through funding to the UPNG’s

School of Medicine and Health Sciences, and technical and training support from the Royal Australasian College of Surgeons.

- **Education** Some elements of the aid program's assistance to PNG's schools have been controversial (the elementary school reforms and the new curriculum in particular). But aid-funded teacher training, school building, school maintenance grants, and support for community oversight of schools have provided strong support to the sector, and national basic schooling indicators are now improving (Section 1.1). The aid program also awards over 100 tertiary scholarships a year. Many of PNG's government, business, academia and community leaders are scholarship alumni, including several Ministers and Heads of Departments, the Chief Ombudsman, and the Vice Chancellors of the PNG University of Technology and the University of Goroka.
- **Support to important government and non-government institutions.** The aid program has provided significant support with visible results to critical government and non-government institutions. The government institutions include the PNG Treasury, the Ombudsman Commission, the Electoral Commission, and the Auditor General's. The non-government and quasi-governmental institutions include the National Research Institute, the Medical Research Institute, the National Agricultural Research Institute, and the National Economic and Fiscal Commission. It is no exaggeration to say that without support from aid program, some of these organizations might have collapsed, and all of them would be significantly weaker than they are today. So, too, would PNG.

Section 2. Technical assistance

*Consider and recommend: "appropriate future balance in the use of different forms of aid, including training and technical assistance, capital investments and direct support for service delivery and community development."*⁶

2.1 Analysis

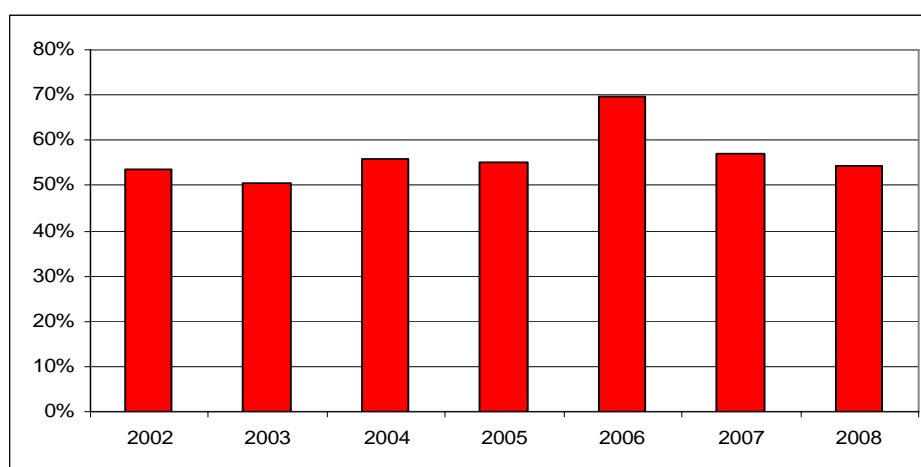
The heavy reliance on technical assistance for capacity building in the Australian aid program to PNG is its most controversial aspect. The emphasis on technical assistance and capacity building in the aid program is deeply embedded and long held. The 1987 Joint Declaration of Principles between the two countries includes as one of its nine basic principles that: "Development co-operation will comprise a wide-ranging combination of agreed measures designed to contribute to development and self-reliance, including capacity building, in Papua New Guinea."

⁶ Issues relating to capital investment and support for service delivery are addressed in Section 3 and community development in Section 6. This section is focused on technical assistance, including training.

Depending on how it is measured, technical assistance makes up about half of the aid program, perhaps more. AusAID reports to OECD on the portion of its funds spent as technical assistance (or cooperation).⁷ According to this data, at least 50% of aid to PNG is technical assistance; 70% in 2006 (Figure 9). These levels are high by global standards, but consistent with AusAID's specialization in technical assistance: at a global level, about half of Australia's aid is given as technical assistance, more than double the global average (Batten, 2009). AusAID, in request to a response from the PNG Department of National Planning and Monitoring, has recently done a more detailed analysis for the current year, 2010. This suggests that technical assistance makes up 45% of the aid program (with consultancies at about 34% and training at about 11%). 27% is expended on goods and services, and 28% on other, a mix of overheads and expenditures which are difficult to classify. If the other category is allocated between the two major categories, then the breakdown between technical assistance and goods and services is 62-38%.

The aid program employs about 360 technical assistance personnel. This includes 50 from the Australian Government. The rest are hired as consultants. There are 240 long-term advisers, 50 short-term advisers, and 60 contract officers (PNG nationals working in the Health Department). Of the 240 long-term advisers, about 60 are PNG nationals, and another 34 are foreign nationals from a country other than Australia. The increasing number of PNG nationals hired under the aid program helps foster PNG participation in the aid program, but gives rise to concerns about inadvertently drawing talent from the national organizations the aid program is setting out to help.

Figure 9 Proportion of Australian aid to PNG as technical assistance



Source: OECD DAC.

Note: Data reported by AusAID to DAC.

⁷ Technical Assistance (or Cooperation) is defined by the OECD DAC as the provision of know-how in the form of personnel, training, and research and associated costs. This includes donor-financed activities that augment the level of knowledge, skills, technical know-how or productive aptitudes of people in developing countries; and services such as consultancies, technical support or the provision of know-how that contributes to the execution of a capital project. Technical assistance includes both free standing technical assistance and technical assistance that is embedded in investment programs (or included in program-based approaches). Technical assistance includes scholarships.

Any recommendation concerning the continuation of the reliance on technical assistance must rest first and foremost on an assessment of the effectiveness of this approach. This is a matter on which views differ and in what follows we try to take a balanced and comprehensive approach.

First, there have clearly been some success stories. As was noted in Section 1.2, there are a wide range of important PNG institutions that have benefited from the provision of technical assistance through the PNG aid program.

Second, there is a strong demand for advisers from the PNG Government. In the Law and Justice sector, the participating Government of PNG (GoPNG) agencies can choose between advisers and physical investments. The result is a high demand for advisers, with over 60% of funds being used for technical assistance. Despite dissatisfaction with the reliance of the aid program on technical assistance, there are frequent and uncoordinated requests from the Government of PNG to the Australian Government for additional advisers in specific areas.⁸

Third, the aid program has made considerable effort to improve the efficacy of its capacity building support, including through: the untying of aid; better monitoring and evaluation; greater involvement by GoPNG in selection and reporting procedures; internationally recognized efforts to improve awareness of and sensitivity to how technical assistance can better contribute to capacity building; reduced reliance on imported but perhaps inappropriate international “best practice” and more on strengthening local systems; increased willingness to fund alternative means of capacity building such as investments in IT systems and other infrastructure; and increased emphasis on more disciplined assessment of the need for consultants prior to their hiring. All of these initiatives have already made progress, and should continue to be emphasized.

Fourth, increased government revenues expected from the LNG project in particular and more generally from the resources boom place a premium on capacity building. There will likely be both a leakage of government staff to the private sector and a greater premium on government capacity to manage a more complicated set of economic and financial challenges and a larger budget. This logic would suggest a greater emphasis on capacity building, not a lesser one.

At the same time, there are strong indications that the “capacity building through advisers” model is not working. It is notoriously difficult to assess the impact of technical assistance on capacity building, because often the benefits are intangible, and the counter-factual is so difficult to define. But in the case of PNG, several different sources of evidence all point in the same direction.

⁸ Given that technical assistance is essentially free for individual government departments, this is perhaps not surprising. It is also possible that departments overlook the non-financial costs of overuse of consultants in terms of staff morale and possible capacity erosion.

First, overall government effectiveness and capacity in PNG are declining. This is confirmed by the World Bank indicators shown earlier (see Figure 3), and was noted to us by many interlocutors.

Second, formal evaluations and other feedback suggest much technical assistance has had little impact in key areas. Though one might argue that government capacity in PNG would be even lower without the provision of technical assistance, the evidence suggests that much technical assistance has simply made little difference:

- The AusAID Office of Development Effectiveness (ODE) synthesized for us a number of their and AusAID reviews. On technical assistance (TA), their summary finding is: “The reviews are generally critical of the reliance on international TA especially in advisory roles, and especially focused in Port Moresby.” (2010, p.8)
- An evaluation of technical assistance to the health sector concluded that: “... the high volume of support personnel and the enthusiasm they [advisors] have brought has resulted, at national level, in a perception that ... there has been too much technical assistance, resulting in at best duplication of effort, and at worst, suppression of activity” (a health sector independent completion review quoted in ODE, 2008, p.32).
- Another more recent health sector evaluation concluded: “TA has been extensive and wide-ranging, accounting for nearly half of AusAID expenditure [in the health sector]. Although it made positive contributions, some of which have had lasting impact, the team’s judgement is that the results are not commensurate with the level of spending. Expenditure of \$150 to \$200 million on TA has not produced a step improvement in performance or capacity. A better balance between TA and operating costs would arguably have achieved more.” (ODE, 2009, p.40)
- The 2000-2005 \$43 million Curriculum Reform and Improvement Project introduced a new outcomes-based education (OBE) curriculum for PNG schools. *Vision 2050* reports that “Extensive consultations throughout the country indicated that there is an overwhelming dissatisfaction with the newly introduced ...[OBE] curriculum.” (2010, p.34)
- There are often questions around the sustainability of TA-induced improvements. One example is that, of 11 achievements one financial adviser claimed, only two or three were in evidence to his/her successor (Morgan, 2008).
- In the core areas of government, we were told that Australian advisers were unable to prevent large scale corruption from continuing in departments where they were engaged.

Third, we heard of many generic problems which influence public sector capacity in PNG, and which are beyond the power of advisers, and indeed the aid program, to address. There is no doubt that weak governance is a binding constraint to development in PNG; the question is the extent to which technical assistance can improve governance. The GoPNG-commissioned 2007 *Review of the Public Sector Reform Programme* found donor programs “have facilitated the building of substantial capacity in many agencies” but that there is “a high risk of regression” after advisers depart (Kavanamur and Robbins, 2007, p.56). More generally, however, the Review concluded that: “the public sector regarded the most critical driver of public sector reform to be political credibility, ownership and leadership. Without these,

efforts to undertake reform will founder on the basis of a lack of political will, sincerity and commitment.” (p.9) The Review also tabulated a list of factors contributing to the problems facing the public sector (pp.8-9):

- “absence of political and senior executive leadership;
- lack of genuine political and managerial commitment to reform;
- absence of a clear strategy and unequivocal ownership;
- poor levels of organisational leadership, capacity and knowledge
- low levels of corporate knowledge within a declining knowledge base;
- erosion of public sector values and capacities through the politicisation of the public service;
- poorly trained and experienced appointees to senior positions, especially at the head of agency level;
- disrespect for the rule of law among many politicians and senior public servants;
- limited enforceability of accountability and appropriate sanctions;
- political interference with due process; and
- loss of institutional and process credibility.”

It is hard to see how the provision of advisers can help address any let alone solve all of these problems (to which we would add, absence of and rapid turnover in counterparts). As one commentator has put it: “Failure to hold others to account is one of the chief weaknesses of the PNG public sector. This reluctance is unlikely to be remedied with the application of a thin layer of capacity-building, and more likely will require fundamental evolution of the political system.” (Whimp, 2009, p. 143)

Fourth, some consultants spend too little time in country to make a real difference. The average duration of a long-term consultant’s stay under the Australian Support Facility II (ASFII), the main technical assistance facility, was just 17 months. By contrast, the consultant most associated with the acclaimed recent provincial financing reforms worked as a consultant for five years, and spent most of her working life before that in PNG. A year or two is often too short a time to make a sustained difference in a complex environment such as PNG.

Fifth, the limited impact of technical assistance is not confined to PNG. As early as 1993, a UNDP-led review of technical assistance to Africa argued that there was “excessive reliance on one model of delivery for technical assistance - the resident expatriate-counterpart model, which has failed as an instrument for capacity building”. (Berg, 1993). Another report on Africa, this one in 2005 from the World Bank Operations Evaluation Department concluded that “The Bank’s traditional tools – technical assistance and training – have often proved ineffective in helping to build sustained public sector capacity.” (World Bank, 2005, p. viii) A series of articles and reports have provided a number of reasons for why technical assistance so often fails to build capacity:

- Good institutions are critical for development success, but are determined by domestic factors. “[I]nsufficient domestic demand for institutions or institutional reform is the single most important obstacle to institutional development in poor countries” (Fukayama, 2005, p. 47). This

is something donors have very little influence over. Technical policy skills are only useful if the domestic incentives are aligned for reform (Collier, 2007).

- Absent political leadership, anti-corruption strategies are destined to fail (Quah, 2004).
- Technical assistance has proved useful in combating technical, tightly defined problems, where it has “transferred technical procedures into non-politicized environments” but much less successful in meeting more amorphous capacity building goals (Morgan, 2002).
- It is often difficult to know in any given setting which institutional or policy reforms will actually improve prospects for growth and service delivery; the right fit is very country-specific. Thus, transferable knowledge about many aspects of desirable institutional reform is low (Rodrik, 2008; Fukayama, 2005).
- The weaker capacity is to start with, the harder it is to build (the so-called “governance paradox” of Steedman, 1994).
- The dispersed nature of service delivery responsibilities makes them largely impervious to technical assistance interventions (Pritchett and Woolcock, 2008).

The emphasis on technical assistance for capacity building and the lack of much to show for it is at the heart of the political difficulties the Australian aid program to PNG is facing. There have been long-standing concerns about “boomerang aid”, that is, excessive amounts of the aid program benefiting Australians rather than Papua New Guineans. Foreign aid involves the provision of foreign exchange which needs to be spent (ultimately if not immediately) on the import of foreign goods and services. With aid untied and a range of nationalities working as advisers the boomerang criticism should have less sting to it. However, the clear visibility of Australian advisers across the PNG public sector, and the little that one can show in terms of advisory impact no doubt creates a fertile environment within which boomerang accusations continue to be made.

The reliance of the aid program on technical assistance has lost political support. The PNG Prime Minister has long been critical, and has recently argued for fewer advisers and more resources directed to service delivery (Somare, 2009). The Australian Prime Minister conceded last year: “too much money has been consumed by consultants and not enough money was actually delivered to essential assistance in teaching, in infrastructure, in health services on the ground, in the villages” (Rudd, 2009). PNG Opposition Leader Sir Mekere Morauta has also voiced his concerns over Australian technical assistance, arguing that “[h]undreds of millions have been spent or are being spent on capacity building, but nothing really has eventuated” (Marshall, 2008).

2.2 Recommendations

Real change in this area is needed to improve aid effectiveness. A balanced approach is called for. On the one hand, further refinement of a capacity building model that has been discredited both internationally and within PNG will not suffice. On the other, it must be recognized that there will be ongoing demand and need for expertise to be financed by the aid program, and indeed increased demand in light of the LNG project. Our recommendations are designed to signal a new approach, but not to abandon the use of the aid program to support better public sector management.

The first recommendation is simply to agree on a single method for regular reporting of technical assistance volumes. Agreement on a method for measuring technical assistance, and then regular monitoring using that method, would help establish clarity and build confidence. The approach developed by the National Department of Planning and Monitoring which divides all aid spending into consultancies, training, goods and services and others seems appropriate, though further work is needed to ensure definitions are being applied consistently across the aid program.

Our second recommendation is to reduce reliance on technical assistance. Such a strategy would protect high-value technical assistance, but would weed out low-impact assignments. It would force greater realism and a better prioritization. It would be consistent with intentions already announced by both Prime Ministers, and indeed embedded in the Review's terms of reference, to expand aid-funded investments in economic and social infrastructure. It would also be consistent with the agreement implicit in the Partnership for Development schedules to reduce reliance on technical assistance.⁹ Finally, it would be in line with the Australian 2006 Aid White Paper commitment to use technical assistance more selectively¹⁰ and with the PNG Development Strategic Plan intention to significantly reduce technical assistance as a proportion of aid. Indeed, we note that in some sectors, such as education, there has already been a move to reduce the proportion of spending on consultants.

Beyond the suggestion that reliance on Australian TA be defined as a ratio of technical assistance to total aid from Australia, we do not propose a specific target. This would require further discussion. A process of review and updating would also be needed, and some flexibility would need to be retained. It is possible to foresee, for example, that Australia and PNG might agree on a major policing initiative, which would be in the form of personnel.

It would also be useful if individual sectors agreed on their own TA limits. This would be particularly useful for those sectors – law and justice, education, health – where there is a clear trade-off between the provision of goods and the provision of consultants, and it would help prevent overuse of the latter from crowding out the former. Cost-sharing mechanisms, under which agencies pay some part of the salary of the consultants they demand, would also help instil greater discipline. This is currently the exception rather than the rule in the aid program.

Third, existing approaches to and facilities for TA provide useful umbrella mechanisms within which most requests for further technical assistance can be considered. Facilities already exist to bring in technical assistance in the law and justice, health, education, and transport sectors, as well as in the broader area of public sector and economic management. Wherever possible, requests for new technical assistance

⁹ We note that in both the health and education schedules, performance indicators include the proportion of funds given as technical assistance. Though no target is provided, we assume that the intention is for this indicator to fall over time.

¹⁰ The ODE synthesis of PNG evaluations also recommends "Reduce[d] reliance on technical assistance." (2010, p.8).

should be referred to existing mechanisms. This will provide a ready means to respond to new requests for TA, encourage greater prioritization, and avoid a blow out in total technical assistance. New TA facilities and separate arrangements should be discouraged.

Fourth, there should be a continuation of efforts to ensure that the primary line of reporting for all advisers is to the PNG government department or agency concerned rather than to the Australian government or contracting company. Good practice for technical assistance requires that “TA personnel should be unambiguously accountable to the host organisations they serve” (Land, 2007). Reporting arrangements seem to vary across the aid program, but, while progress has been made, do not in general reach this ideal. Development of new cross-program guidelines might help, as would a reduced reporting burden on consultants to managing contractors, and more flexible terms of reference (which allow consultants to respond to emerging demands and opportunities). We do note that personnel management is often weak in the PNG Government, and that sometimes host departments are reluctant to dispense with the services of incompetent consultants. This suggests a role for the aid program, not in directly supervising consultants, but in monitoring that departments are getting value for money from aid-funded consultancies, and in intervening in cases where they are not.

Fifth, the average duration of consultant hires should be monitored and targeted to increase. Of course, in the case of any individual consultant, duration of hire should be subject to evidence of demand and effectiveness. But in general, consultants, if they are brought in, should be engaged with an expectation that they will serve for a longer period than the current average of a year and a half.

Sixth, there should be a reduced focus on corporate reforms, and a greater focus on implementation of critical tasks, perhaps with a greater proportion number of positions based outside of Port Moresby. We note from the independent completion review of ASFII (Morgan, 2008), for example, that many of aid program’s advisers work on developing new corporate plans (40% of a sample of ASF advisers had this as one of their tasks) and on departmental reorganizations (one-third). Even the sub-national initiative seems to have focused on the development of corporate plans and on strengthening corporate services. We question this focus. As one PNG Minister put it to us: “We have far too many plans in PNG and too little effective implementation.” We are of the view that increasingly consultants should be engaged with responsibility for, or at least to assist on, critical tasks of service delivery, such as the distribution of drugs, or the supervision of health centres, or the maintenance of provincial roads. When engaged in non-frontline areas, consultants should also be encouraged more to support their agency to perform their core functions better, and less to deliver on big ticket restructurings, plans and other discrete “deliverables.” To ensure that TA is able to deliver on implementation, more effort needs to go in to ensuring that consultants have the technical skills required by their position. The strong technical skills of SGP personnel serve as a model of what is needed here.

Seventh, greater attention should be given to cost-effectiveness. As virtually a monopsonist (monopoly buyer) of expatriate public service advisers in PNG, the Australian aid program could do more to drive down costs. For example, the aid program could set price guidelines for particular skills, and for living

allowances. Uniform guidelines are particularly important for the hiring of national staff, where there is a risk, seen in many aid-dependent countries, that attractive aid-funded salaries will draw talent out of the public sector. The evidence suggests that considerable cost savings will result from the aid program funding organizations to hire expatriate staff, rather than itself recruiting them directly.¹¹ Continued and expanded use of international markets will broaden the pool, and both drive up skills and drive down costs. Finally, the wide range in costs for different ways of meeting skill shortages – from hiring different types of consultants, or volunteers, or even national staff – suggests the scope for large cost savings by ensuring the right type is chosen for the job at hand.¹²

Eighth, and most importantly, consideration should be given to the funding of in-line positions. We were surprised by the number of times this came up as an issue during our consultations. In the words of one Provincial Administrator: “Advisers are outside the system. They find it very difficult to tell [staff] what to do. They are not attached to any position number in the civil service. They’ve got to be in the action, in the ‘tribe’, not outside.”

Using Australian aid to fund in-line positions would be a return to earlier days, when budget support was often used for this purpose. A revealing set of interviews with eminent former PNG civil servants synthesized by Lynn Pieper suggests that moving away from this model was a mistake: “[After independence], expatriate personnel were in contracted, line positions, subject to normal lines of command, discipline, and public service ethics. The shift to off-line, advisory support during the 1980s, whilst a well-intentioned part of the localisation process, ‘was a step backwards’ in the opinion of interviewees. Apart from being much more expensive, it has created a feeling of condescension between ‘advisers’ and their ‘counterparts’; reduced sustainability prospects by separating the work done by advisers from the ‘normal’ work of departments; created a dependency by Departmental Heads on using advisers to fix problems rather than training nationals to learn the job by doing it; destroyed the collegiate sense that previously existed (‘we used to work and socialise together’); and eroded any

¹¹ The Institute of Medical Research hires its own expatriates (into in-line positions, not as advisers) using budgetary support which the aid program provides. The cost of a mid-level expatriate salary under this route appears to be about K200,000 or about \$100,000. This excludes rental and security costs (which are provided separately), but on other hand includes tax, whereas aid-program-funded salaries are tax free. IMR is able to recruit highly qualified staff at these rates, which are (very roughly) about one-half of the cost of consultants engaged directly by the aid program.

¹² A 2007 AusAID ODE review of economic governance gave the following indicative costs for hiring of different types of advisers and public servants (ODE, 2007, p.23):

- \$400,000 for a mid-level government deployee (under the ECP/SGP).
- \$340,000 for a mid-level consultant (under the Advisory Support Facility).
- \$150,000 for an expatriate hired directly by the PNG government
- \$55,000 for an ODI Fellow
- \$6,000 for a national graduate.

Note that salaries under SGP and ASF are tax free, and that these are not necessarily all-in costs. The average cost of a volunteer to the aid program is about \$40,000. The suggestion here is not “the cheaper, the better” but that the wide range of costs involved suggests a range of alternatives should be examined, and that cost-effectiveness considerations should be kept in mind.

sense of pride in achievements – counterparts do not have any sense of ownership of results, and advisers today ‘are not long term stayers’.” (Pieper, 2004, p.3)

The in-line model was used effectively by another small resource-rich country, Botswana. In Botswana, “TA personnel [were] generally assigned to established posts (line positions) rather than to projects or advisory positions; and TA personnel are contracted by, and [were] responsible to the government in the first instance, and to the sponsoring donor second.” (Land, 2002).

A number of consultants in PNG already undertake tasks other than capacity building. Some help implement the aid program, some are engaged on government tasks. The most-celebrated TA triumph in recent years – the work with the National Economic and Fiscal Commission – arose from assigning consultants responsibility not for capacity building or advising but for the delivery with counterparts of a specific task: a new funding formula for provincial governments. Recent aid program guidelines note the different roles which TA can play, including “doing” and “advising,” and the situations in which each may be most appropriate. This pragmatism is to be welcomed, and a greater emphasis on “doing” would be consistent with the suggested increased focus on implementation. This recommendation goes further, however. At the current time very few aid-funded personnel are actually hired into in-line positions.¹³ Funding in-line positions would go beyond setting advisers concrete tasks, or embedding them into a team which has responsibility for specific tasks (the “embedded adviser” approach). Under the in-line approach, aid-funded personnel would operate with and under whatever authority and reporting lines normally go with the position they are hired into. This would promote both accountability and effectiveness, and through the training of junior staff would make an important contribution to capacity building. There would be less risk of displacement of local effort, since the in-line model would do away with the practice under the current advisory approach in which the adviser is there only to help, which means that the more the adviser does, the less work there is for the person or team s/he is helping.

Aid-funded personnel occupying in-line positions would not normally be Australian government staff. The Enhanced Cooperation Program had the insight that it might be useful to have the aid program fund in-line positions, but the flaw which quickly undermined the ECP was that any aid-funded in-line positions had to be filled by Australian government staff. This created the perception, if not the reality, of conflict of interest, and infringement of sovereignty. As a result, the ECP/SGP program increasingly operates as an advisory facility. What is needed now is the possibility to fill in-line positions through the aid program, but not through reliance on Australian government staff.

Recruiting expatriates into in-line positions could be done either on a sectoral basis or could be centralized. GoPNG could indicate where they need expatriates to fill particular positions. AusAID would

¹³ There are a large number of AusAID-funded consultants in the health sector operating in in-line mode due to staff shortages in the Department: some 60 national “programme officers”. Staff in the Public Sector Workforce Development Program (PWSDP) are also AusAID-funded consultants operating in in-line mode. Apart from that there are a few advisers who operate informally in an “in-line” mode (for example a Legal Adviser to the Public Accounts Committee).

agree (or not), and, could assist PNG in its search and with logistics. To promote local ownership, and to keep down overall costs, the PNG Government could be responsible for payment of the local wage, and the aid program for the funding of an agreed salary supplement. Hiring would typically be for a fixed term. Accountability of such staff would automatically be to their PNG Government supervisor. Contract agreements would include commitments to avoid corrupt behaviour, and guidelines on how to report corruption among peers or supervisors, and how to deal with corruption among juniors. As with any other activity, the aid program would monitor overall effectiveness.

Using the aid program to fund in-line positions is a controversial suggestion, but one which has strong support. It should not be mandated, but rather piloted by those willing to use it. Clearly, the in-line approach will only work if the widespread support we found for it is translated into concrete demand. We suggest that views be canvassed to find agencies willing to pilot an in-line approach.

2. Technical assistance: summary of recommendations

- 2.1 *Agree on a common, single definition to measure the volume of technical assistance (TA), and regularly monitor and report levels of TA support.*
- 2.2 *To reduce reliance on technical assistance, target the proportion spent on technical assistance to decline. Consider also setting sectoral targets, and introducing cost-sharing mechanisms.*
- 2.3 *Wherever possible, use existing technical assistance facilities to consider and process new TA requests.*
- 2.4 *Ensure that the primary line of reporting for all aid-funded personnel is to the PNG Government.*
- 2.5 *Target an extension of the average duration of hire of aid-funded personnel.*
- 2.6 *Reduce the focus of aid-funded positions on corporate processes, and increase that on implementation, including with positions outside of Port Moresby.*
- 2.7 *Give greater attention to cost-effectiveness, and adopt measures that will drive down the cost of technical assistance.*
- 2.8 *Most importantly, pilot the use of aid funded in-line positions.*

Section 3. Sectoral focus

This section responds to three parts of our terms of reference:

- *In Section 3.1, “mechanisms to progressively and substantially increase ODA investment in economic and social infrastructure in PNG” and “an appropriate role for Australia’s development cooperation program in relation to new and emerging issues including, but not limited to, climate change, HIV/AIDS, trade and private sector development and the national development opportunities presented by growth in the PNG economy.”*
- *In Section 3.2, the balance between “capital investments and direct support for service delivery.”*

3.1 Focus and responsiveness

If the heavy reliance on technical assistance is the most remarked-on aspect of the aid program, the thin spread of the program is the second. Many stakeholders raised this issue, and gave it as a reason for the

apparent lack of impact of Australia's aid. And, indeed, it is difficult to find an area of important government activity in PNG where the Australian aid program is not somehow engaged. In addition, within some sectors the aid program appears to be highly fragmented. For example, in the area of school education, despite a recent consolidation of activities, the aid program still funds the delivery of textbooks, the training of teachers, the building of classrooms, school maintenance, the provision of technical advice and, from this year, the payment of cash grants to schools. All this in a context where per capita Australian aid spending on education is about K60 per student, and one-tenth of PNG Government funding. The high level of fragmentation in aid to PNG by international standards, seen in Figure 7, despite the absence of a large and diverse group of donors (often exceeding 30 in many other aid-receiving countries), tells a powerful story about the thin spread of Australia's aid to PNG.

Increasing focus is a difficult but important challenge. Given Australia's dominant aid position in PNG, and the Partnership for Development, which commits to aid activity in eight sectors, it is difficult to envisage the aid program greatly narrowing its sectoral coverage. And the aid program does need to remain responsive and open to new challenges. At the same time, it would also benefit from increased focus. Selectivity is an important and internationally accepted principle of aid effectiveness. Its greater application in PNG would improve the accountability of the aid program, reduce transaction costs, and help address the perception that the aid program is not having an impact.

It might be difficult to drop sectors altogether, but one or two could be selected as flagships. Flagship sectors would be the biggest recipients of aid, and receive the greatest attention from both Governments. Other sectors would not be vacated, but would receive a lower priority in discussions and funding. Implicitly, governance has been the flagship program for the last decade, but not by mutual acclaim. Given the desire of both parties, as it is put in our terms of reference, to "progressively and substantially increase ODA investment in economic and social infrastructure in PNG," a shift is warranted. Candidate flagship sectors are discussed further below.

In addition, simplification within each sector would also improve selectivity. Given that it will nevertheless be difficult to reduce the sectoral spread of the program, another aim should be to simplify and increase focus within each sector. This is a matter of identifying "priorities within priorities." We provide some suggestions for how this might be done in Section 7 on aid modalities.

The aid program needs to be reoriented to give greater support to economic growth, but without further fragmentation. In relation to the specific issues raised in our terms of reference – "climate change, HIV/AIDS, trade and private sector development and the national development opportunities presented by growth in the PNG economy" – the aid program is already responding to HIV/AIDS and to climate change. Several stakeholders said the aid program should be doing more in relation to private sector development and rural development, and that more generally the aid program should focus less on the social sectors and more on economic growth. We accept that economic growth is of fundamental importance for PNG, and we agree that the aid program should engage more with the private sector, a theme we return to in Section 6 on delivery mechanisms. However, if, say, rural development were to become another major activity area for the Australian government, it would further reduce focus and

increase spread. Also, the sort of activity this would involve, such as strengthening agricultural extension services, would have no greater guarantee of success than, and involve the same service delivery challenges as, the current priority areas of health and education.

Rather, opportunities should be sought to expand areas of current aid engagement which have a direct impact on growth. This could include spending in the roads sector and in education. With respect to roads, as one interlocutor put it: "Roads is the number one priority. Once roads are in place, people can take care of themselves with little involvement from government." In education, there is strong support for a greater focus on vocational and higher education to intensify the link to growth.

The decision to expand in particular sectors should take into account not only links to growth, but also absorptive capacity. Capacity constraints are particularly binding in the area of transport infrastructure. We were informed that the Department of Works in 2009 was only able to spend about K100m of its budget (excluding aid) of over K300m and that only 50% of Australian aid commitments for road maintenance could be expended in the same year. Road maintenance contracts financed by the Asian Development Bank are similarly delayed, with projects typically taking twice the contracted time. Both Governments need to pay urgent attention to the issue of expanding capacity for the roads sector. Greater predictability of funding over the medium term, and faster processing of contracts would all help entice new entrants. At the same time, however, realism demands that it be recognized that implementation constraints in the infrastructure sector are likely to worsen before they improve due to the resources boom and in particular the massive construction associated with the LNG project.

The capacity of the education sector to spend more funds usefully appears to be less constrained. This is not to underestimate the difficulties of improving education quality, especially if the focus were to expand to include tertiary, vocational and secondary education. However, across the sector, budgets are dominated by staff costs, and there is a dearth of non-salary recurrent funding, which the aid program could productively be used to address.

This logic suggests that education become the flagship sector for the Australian aid program to PNG. A focus on education, including tertiary and technical education, would also help address one of the underlying constraints on PNG government capacity (as recognized by the PNG *Development Strategic Plan*), and would be consistent with the Government of Australia's increased emphasis on education in its aid program worldwide (Smith and McMullen, 2009).

The Partnership for Development schedule for basic education already flags an increase in spending from K75 million in 2009 to K200 million in 2014. But this still leaves, according to the same schedule, a massive funding gap of K1 billion annually to achieve PNG's basic education goal (net enrolment rate of 70% by 2015). In the context of continued good performance, significant additional funding for basic education could certainly be considered. Substantial new commitments could also productively be made in the secondary, tertiary and technical education sub-sectors based on work currently

underway.¹⁴ AusAID has provided us with \$650 million annually as a reasonable indicator for Australian aid to PNG by 2015. If overall spending in the non-flagship sectors was continued at current levels – excluding education, about \$330 million annually – then education spending could be expanded to about half of the total Australian aid program. In turn, this would provide the aid program with a core focus and a coherence which it currently lacks. While these figures are only illustrative, and flexibility will always be required in implementation, they suggest the sort of changes in composition which could occur in the aid program if the principle of greater sectoral focus was accepted.

3.2 Balance between capital investments and recurrent spending

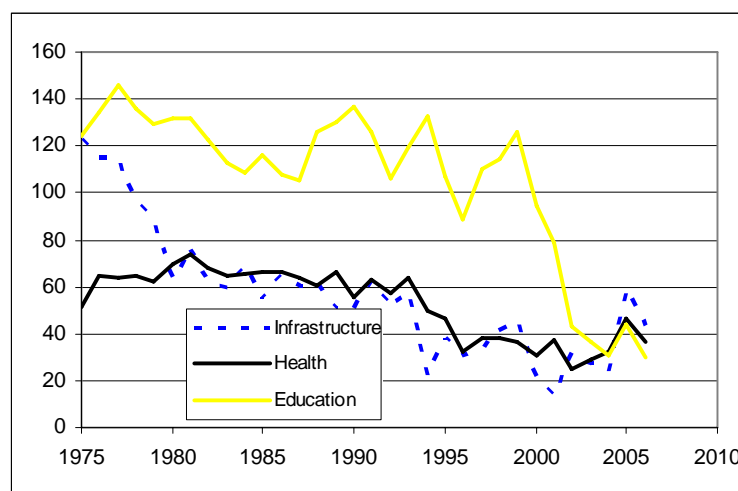
The terms of reference ask us to advise on the appropriate balance between “capital investments and direct support for service delivery,” the latter of which we interpret as recurrent spending. Clearly both are needed, especially given the rundown nature of much of PNG’s infrastructure which requires rehabilitation or rebuilding rather than simply maintenance. Capital investment has the advantage of being more tangible, and thus “high impact,” but can create additional and unaffordable recurrent costs in the future.

Our diagnosis supports a strong focus for the aid program on recurrent spending. (This includes roads maintenance, even though this is actually included in the PNG development budget.) We are persuaded by the analysis of the National Economic and Fiscal Commission (NEFC) and others that there is very significant underfunding of the recurrent budget in PNG with “... the current level of spending on recurrent goods and services in priority areas continuing to be too low and inadequate [emphasis in original]. If this trend continues, the implications are dire for government efforts in promoting core services, such as health and education, and for promoting economic development, through a maintained road infrastructure and by developing a vibrant and sustainable agricultural sector.” (NEFC, 2009, p. v). Using conservative benchmarks, the NEFC found that non-salary recurrent spending was 25% of required levels in health, 14% in infrastructure, 59% in education, and 41% in agriculture (NEFC, 2009, p. vi).

Underfunding of the recurrent budget is also suggested by long-term declines in key categories of spending. As Figure 10 shows, adjusting for inflation, annual education and infrastructure per capita spending has fallen from K120 at independence to only K40 today. Health spending has fallen from about K60 per person in the 1980s to under K40 per person now. Higher education spending (not shown separately) is about one-tenth per student of what it was at the time of independence.

¹⁴ The Australian and PNG Prime Ministers have commissioned a report on higher education in PNG from Sir Rabbie Namilau and Professor Ross Garnaut. Preparatory work is also underway on an expanded engagement in the technical and vocational sub-sector.

Figure 10 Government per capita expenditure by sector (Kina in 1999 prices)



Source: Batten (2009).

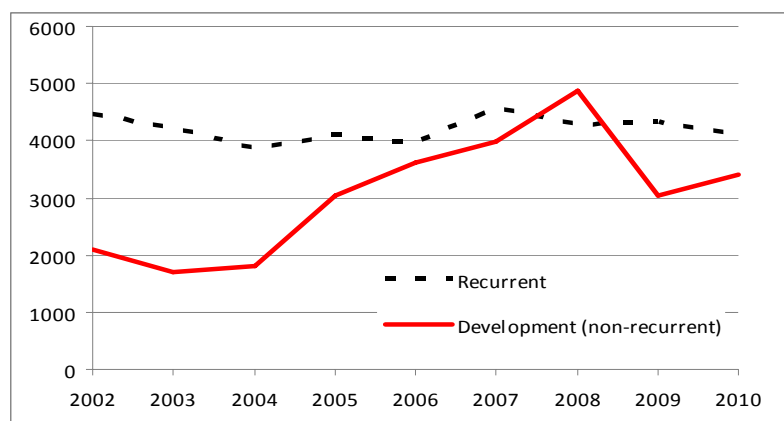
Studies for PNG and other countries typically show that recurrent spending has higher returns than capital spending. In PNG routine maintenance of sealed roads costs about K4,000/km, but reconstruction costs about K550,000/km, more than 100 times more (NEFC, 2009, p. 67). In a context in which, we were informed, the effective PNG roads network is declining in size, protecting existing assets has to have top priority.¹⁵

Recent and forecast budgetary trends reinforce the need for greater aid support for recurrent spending. There has already been a large increase in non-recurrent spending through the PNG development budget.¹⁶ In real terms, recurrent spending this year (2010) is at the same level as at 2002. But development spending is 50% higher (Figure 11). While PNG will receive a very significant budget boost from LNG revenues starting around 2018, current government projections suggest a very tight fiscal position before that. Current projections show a decline in total revenue and no increase at all in recurrent spending (Figure 12), which means that per capita spending on education and health will continue to decline.

¹⁵ "Roads connecting rural areas with the main road networks are now in an advanced stage of deterioration. About half of all feeder roads are impassable to vehicles carrying significant loads. Sealed roads have degenerated into poor gravel roads, gravel roads have been reduced to earth tracks and some routes have been closed altogether." (Gumbis, 2010, p.206)

¹⁶ Although some recurrent funding (e.g. roads maintenance) is included in the development budget, the former constitutes only a small portion of the latter.

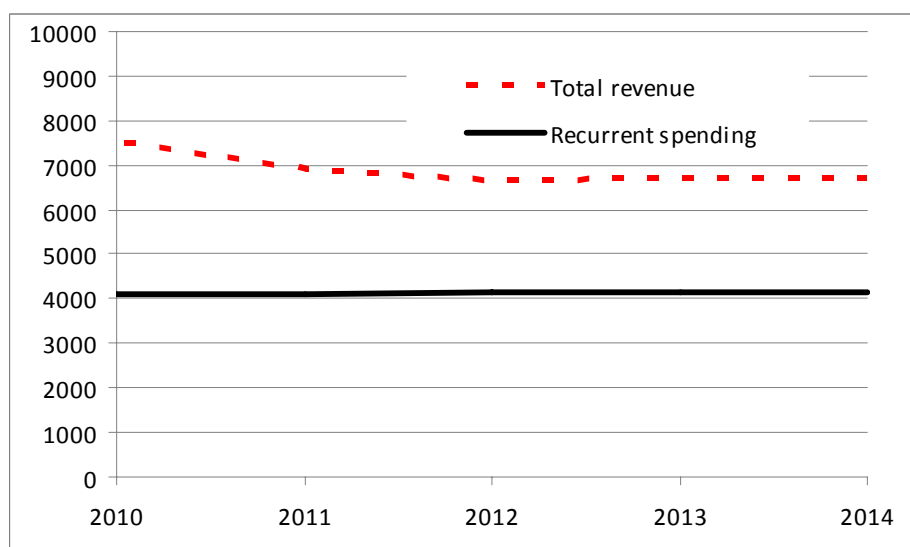
Figure 11 Development and recurrent spending (Kina million), 2002 to 2010, adjusted for inflation



Source: PNG Budget documents, various years.

Note: 2010 prices are used. Trust funds from supplementary revenues are included with development spending. See also footnote 16.

Figure 12 Projected total revenue and recurrent spending (Kina million), 2010 to 2014, adjusted for inflation



Source: PNG 2010 Budget.

Note: 2010 prices are used.

A focus for the aid program on recurrent spending implies that closer links should be sought between the aid program and the recurrent budget. As recognized by the Partnership for Development, greater recurrent spending by the aid budget should preferably be accompanied by greater PNG budgetary commitments. This requires a close link between the aid program and the recurrent budget. At the moment, however, all aid spending enters the development budget. This is fine for road maintenance, which though recurrent in nature is actually in PNG's development budget, but makes less sense for recurrent spending in the sectors of health and education. Section 7 puts forward some ways in which greater links should be sought between the aid program and the recurrent budget.

The risk of crowding-out of government spending can never be eliminated, but mitigating measures can be taken. There is a risk that aid program funding of the recurrent budget will lead to crowding out of government funding, and indeed there is evidence of this sort of fungibility in the past (Batten, 2009). Such risks exist no matter what aid is spent on, and can never entirely be eliminated, but can be reduced. Long-term aid commitments are key, as is a shared approach. This topic is discussed further in Section 5 under the heading of alignment, which discusses the utility of the Partnership for Development schedules, and the importance of a medium-term expenditure framework. Evidence-based dialogue, and a closer link between the aid program and the recurrent budget will also be important.

3. Sectoral focus: summary of recommendations

- 3.1 Greater selectivity and focus in what has and will remain a wide-ranging program could be achieved both by identification of a flagship sector or sectors which would receive the largest share of funding and attention, and by simplification of aid program activity within each aid-funded sector as well.*
- 3.2 We recommend that education (defined broadly to include secondary, technical and tertiary education so as to strengthen the felt need expressed by many stakeholders to use the aid program more purposively to boost PNG growth prospects) become the flagship sector for the Australian aid program to PNG.*
- 3.3 Prioritization by the aid program of recurrent expenditures (including road maintenance) is warranted, and closer links between the aid program and the recurrent budget should be sought.*

Section 4. Support to lower levels of government

Consider and recommend: “an appropriate balance between assistance to the national government and to provinces, districts and local level governments.”

In recent years, the Australian aid program has started to support provincial administrations through its Sub-National Strategy (SNS) and, as part of that, support for the GoPNG Provincial Performance Improvement Initiative (PPII) program. Funds allocated to AusAID’s sub-national strategy have grown from \$14 million in 2008, to \$20 million in 2009, and \$25 million in 2010. This funding is largely used to finance advisers, but about one quarter is available for incentive payments to provinces of up to K1 million at a time.

Most stakeholders were supportive of the aid program’s work with the provinces. The PPII is a Government of PNG program. While advisers are directly provided by the aid program, the incentive funds are sent to the provincial governments through government financial systems. SNS funds are spread thinly with advisers going to 13 provinces plus Bougainville. It would be consistent with the

theme of increasing focus and impact that the aid program work with a smaller number of provinces, truly committed to reform and able to demonstrate improvements against verifiable indicators.¹⁷

Provincial funding should continue to be earmarked by sector. Some stakeholders suggested that the aid program should give un-earmarked funds to provincial governments. For example, instead of giving sectoral funds for health and education, provinces which pre-qualify could be given bundled funds to prioritize as they see fit. However, the Government of PNG has itself moved to earmark provincial spending by sector. It would go against this for the aid program to start giving provinces un-earmarked spending. But better coordination is needed between the sectoral and provincial approaches. As we discuss later, one option could be for the aid program to combine its funding with sectoral functional grants to the provinces (Section 7).

In recent times, the Government of PNG has given far greater emphasis to the district level. For example, large amounts of funding are being allocated to MPs under the District Services Improvement Program. The question has been raised whether, in this context, the aid program should work directly with district and or even with (sub-district) local-level governments. We were informed that the European Union is in the early stages of implementing its Strengthening of Districts and Local Level Governments Project which will focus on building capacity at the district administration and Local-Level Government (LLG) levels.

There would be serious risks from the aid program circumventing provincial administrations and engaging directly at the District or LLG level. It is unlikely that the districts or LLGs are viable service-delivery entities for many tasks. PNG's provinces are already small by international standards. District and LLG governance structures are underdeveloped and subject to political manipulation (CLRC, 2009). Services of course do need to be delivered at the district and local level, but the current functional assignment gives a crucial coordinating role to the provinces, so working at the district and lower levels through the provincial administrations seems appropriate.¹⁸

We do note the advantages of being able to transfer funds directly to facilities, such as schools and health centres. The aid program already provides funds directly to schools for maintenance, for example. A World Bank (2004) survey showed that direct transfers to facilities are likely to increase transparency and reduce corruption and leakage. A recent GoPNG (DPLGA, 2009) report has recommended their use for health facilities. Aid guidelines should mandate public reporting (notices) on the receipt and use of funds to facilities to promote transparency and local-level accountability.

¹⁷ By this we mean, work in the area of sub-national reform. Clearly, it is not feasible to restrict aid activities in their entirety to just a small set of reforming or performing provinces.

¹⁸ We were also made aware in the course of our deliberations of the ongoing debates around the appropriate levels and numbers of government in PNG, but reflection on these is well beyond our terms of reference.

4. Support to lower levels of government: summary of recommendations

- 4.1 *The aid program should continue its support for provincial reform, though we suggest a focus on provincial reform in a smaller number of provinces demonstrably committed to service-delivery improvement.*
- 4.2 *Direct engagement by the aid program at the District or LLG level (circumventing provincial administrations) would carry substantial risk, and should not be proceeded with.*
- 4.3 *Direct payments to the (health or education) facility level are likely to increase transparency and reduce leakage. They are already used in the education sector, and should be trialled in health.*

Section 5. Alignment

Consider and recommend: “any additional measures to ensure that Australian aid is aligned with and supports PNG budget priorities, promotes fiscal sustainability, and is reflected in PNG budget documentation.”

Australian aid to PNG is fully captured in the PNG budget. The 2010 PNG budget reports Australian aid at K881 million (Table 20, Volume 1). AusAID reports on the aid program in a July-June fiscal year, but estimates its calendar 2010 bilateral aid to PNG (excluding contributions made indirectly through third parties) at \$394 million. Using an exchange rate of K1=\$0.4, this implies full capture of Australian aid on the PNG budget.

Most Australian aid promotes fiscal sustainability. Most aid spending on goods and services is for recurrent rather than capital spending (for example, roads maintenance, schools maintenance and textbooks, costs of running the health system). Such spending is easier to sustain than large capital investments, provided that any sudden shifts in spending priorities are avoided, and that any reduction in total aid is gradual and by mutual consent, as discussed in Section 9.

Alignment of the Australian aid program with PNG budget priorities is a fundamental requirement of aid effectiveness, and something sought by both sides. The second recommendation of the 2004 DCT Review was about the importance of “effective management of all public expenditure resources – aid funds must work in concert with GoPNG’s other resources, and be focused on supporting the articulated and jointly agreed priorities.” (Lepani, Morris, and Tuioti, 2004, p.i). This would ensure that greater aid funding does not lead to reduced domestic funding of development priorities, except by mutual agreement.

There are some positive trends in terms of focusing government and aid spending on stated PNG government priorities. The PNG Government has long been concerned that not enough of the aid program is going to support its MTDS priority sectors. The Partnership for Development should, over time, alleviate this concern, especially if more funding is allocated to education, as discussed in Section 3. There has also been progress in recent budgets with increased PNG funding to MTDS sectors.

However, there is not always clarity about what PNG budget priorities are. The large increase in the development budget including spending by Members of Parliament at the district level raise questions about PNG's commitment to address the problem of underfunding of recurrent services (Section 3.2).

The 2006-2010 Medium Term Development Strategy (MTDS) provided very useful operational guidance for donors, and the next 2011-2015 Plan will be equally important. We note that the new PNG Development Strategic Plan was finalized without any consultation with donors. While the country ownership and leadership being shown by the home-grown development of the 2010-2030 Plan is commendable, given that donors still provide about 15% of total government financing, consultation prior to finalization of key planning documents with donors would be helpful, and, indeed, common practice. We recommend that the preparation of the next Medium Term Development Plan (2011-2015) include consultation with donors.

Repeated attempts to forge a tight link between aid and PNG government spending have been made, but have not been sustained.

- Performance benchmarks were first introduced into the aid program following a 1995 review. 25 benchmarks were introduced to determine the nature and extent of future assistance to PNG (Simons Review, 1997, p. 106)
- In 1999, benchmarks were incorporated into the Development Cooperation Treaty (DCT) itself. The DCT benchmarks included both measures of PNG participation in the aid program, and output and budget indicators for roads, health and education. The 2004 DCT Review noted, however, that: "Despite a significant proportion of the benchmark targets not being met, the benchmark system has not been enforced. The failure to achieve the benchmarks did not give rise to any review of the quantity of aid to be available, and there is no evidence to suggest sectoral funding allocations were revised as a result of benchmark performance analysis" (Lepani, Morris, and Tuioti, 2004, p. viii). The Review concluded that: "...[T]he performance benchmark system has been of some limited benefit in highlighting performance issues, but it has clearly not been used as a performance management tool in order to improve the effectiveness of the aid program." (p. viii)
- Following the 2004 Review, the Policy Review and Dialogue system was introduced which tied a portion of the aid program to "performance against jointly agreed indicators of reform." PNG met the agreed benchmarks in 2006 and 2007 and two disbursements of \$30 million and \$35 million respectively were made as a result. The PRD ceased operating at the end of 2008, but without any apparent impact on total aid volumes which have risen sharply in recent years.
- Performance benchmarks are now provided by the Partnership for Development schedules, which are very similar to, though more numerous than, the original 1999 DCT benchmarks. (For example, both the Partnership and the DCT benchmarks require that PNG hold real funding levels in key sectors such as roads and education constant.)
- In the absence of a government-wide expenditure framework, alignment has been sought at the sectoral level. Various plans have been developed for transport, basic education, health, and so

on, often with donor assistance. These sectoral plans have often had little influence over the allocation of budget resources, however.

The usefulness of the Partnership for Development benchmarks is undermined by large funding gaps. Because the targets in the education and transport schedules (which are the only two that are fully costed) only require PNG to maintain funding at current levels (in real terms) they give rise to a very large funding gap. The combined annual funding gap for these two sectors is estimated in the schedules to be in excess of K1 billion by 2014. While we were informed that this revenue gap would be closed through subsequent discussions, given that total revenue in PNG is only K8 billion, and that revenue is projected to decline in real terms (Figure 12), this does not seem realistic. Therefore, the output targets are themselves unrealistic (since it is their costing which gives rise to the funding gap in the first place).

A multi-year expenditure framework (MTEF) is needed. This would indicate how funds would be allocated to major sectors in the coming years, and would provide a basis for setting realistic priority sectoral performance targets. The development of such a framework, for example, through the updating of the 2005-2007 Medium Term Resource Framework (part of the 2006-2010 MTDS), would pull together both development and recurrent expenditures of the Government, and include aid commitments from donor partners. Consistent with the analysis presented earlier in this report (Section 3.2), we suggest that any such plan or framework give first priority to filling the large recurrent funding gaps which still exist with respect to essential services. Major Partnership for Development schedules would be revised once the MTEF is in place.

In the absence of such an GoPNG initiative, experience suggests that approaches to alignment grounded in the aid program will have little impact. In this, as in so many other areas, the tail cannot wag the dog.

In the 2010 budget PNG has allocated road maintenance funds at a level far below that agreed in the Partnership schedule. PNG appears to have only allocated about K100 million for roads infrastructure compared to the K300 million targeted in the Partnership schedule. It is true that there are capacity constraints to road spending, which will need to be addressed if increased allocations are actually to be expended (Section 3.1). But these same constraints will also face road construction, which is funded very generously in the 2010 budget, and part of the way to address PNG's capacity constraints is to enhance predictability, which means sticking to funding commitments over several years. Funding targets for basic education have been met, but only because the Partnership assumed a 3% increase in inflation. With inflation running much higher than this, in real terms education spending has fallen. We urge the Government of PNG to meet its spending commitments under the Partnership schedules.

5. Alignment: summary of recommendations

- 5.1 *The 2011-2015 Medium Term Development Plan will be a crucial document for alignment of the aid program with PNG priorities, and we recommend that its preparation include consultation with donors.*
- 5.2 *The Partnership for Development schedules have the potential to improve alignment between aid and the PNG budget, provided funding commitments are adhered to, and the large funding gaps closed.*
- 5.3 *To close the large funding gaps in the Partnership for Development schedules, and to promote the alignment of aid and budget funds under common development priorities, we recommend that the PNG Government develop a multi-year expenditure framework (MTEF). This would indicate how both development and recurrent, government and aid funds would be utilized to fill critical recurrent funding gaps and achieve realistic priority sectoral performance targets. Major Partnership for Development schedules would be revised once the MTEF is in place.*

Section 6. Delivery mechanisms

Consider and recommend: “appropriate mechanisms for the delivery of Australian ODA, including the local and international private sector, volunteers, civil society and government-to-government programs.”

There are important non-state actors in PNG, including those that receive significant government money but that act as autonomous agencies, that are making effective use of aid funding. Many of the success stories of the aid program seem to involve these non-state actors. Examples we were able to observe included: the National Research Institute, the Institute of Medical Research, and the Clinton Foundation’s work in the Eastern Highlands to strengthen health systems and provide HIV/AIDS testing and treatment. We also heard of important reforms which the aid program had supported not through consultants but through supporting local research, advocacy and consensus-building. The aid program also has a strong record of supporting community organizations and civil society more generally through the Community Development Scheme, the Democratic Governance Transition Program, and the new Strongim Pipol Strongim Nesen program.

In line with the general theme of the report of building on success, there is more the aid program could do to work with non-state actors.

*Several stakeholders suggested that there needs to be more of a focus on the role of churches in delivering basic health and education services. Already, the churches provide about half of PNG’s basic health and education services. Most of the funding comes from the PNG Government. Effectively, for a large part of service provision, PNG has put in place a purchaser-provider model, whereby the government provides the funding and overall policy settings, but outsources actual service delivery. There is increasing consensus in PNG that this is the way to go. *Vision 2050* includes goals to increase the provision of health and education by church groups and the *Development Strategic Plan* aims to strengthen service delivery partnerships with churches. The Government recently signed a State-Church partnership. The National Department of Health has established a Public Private Partnership unit.*

Management of Port Moresby's second largest government medical facility has been handed over to St John PNG (which runs PNG's ambulance service).

Research undertaken to date suggests little difference in the quality of church and government-run schools, but important differences in relation to medical clinics. A World Bank (2004) survey of schools found that church schools were concentrated in more remote areas, but that often there was little difference between church and government schools, including in such core areas as teacher absenteeism and student attendance. By contrast, a study of health facilities (Garner et al., 1990), though now somewhat dated, shows much higher quality at church health centres. The study finds that church centres are somewhat more expensive, but also that government centres with more resources do not necessarily perform better. Note that, unlike in the case of teachers in church schools, who are hired and paid by the government, medical staff in church clinics are hired and paid by the church concerned. The Garner report notes: "Missions often have good communication and supervision networks set up for maintenance of pastoral centres in rural communities, and health facilities are likely to benefit from this system." (1990, p. 58) There is also a strong body of anecdotal evidence that church facilities work better. A much more recent aid-funded review (Health Sector Monitoring and Review Group, 2003) found no difference in outputs (e.g. immunization services) between church and government facilities, but was based on self-reporting rather than inspection, did not look at issues of quality, and was strongly contested. A follow-up review (Sutton, 2006) noted the limitations of the earlier study and concluded that church-funded services "provide services of at least equivalent quality (according to the review) with fewer people who are paid lower salaries."

Can the aid program help PNG make more use of church delivery systems in the health sector? The aid program seems to have had little direct interaction with the churches as service providers, though the church partnership program, which links PNG churches with their Australian counterparts, provides general capacity building support to the churches.¹⁹ Clearly, this would be a long-term endeavour. For a start, clearly more research is needed on the comparative performance of the two types of facilities. The basic suggestion is simple, however. Rather than providing all facilities with support regardless of performance, the aid program would provide additional resources to those organizations which are currently doing a good job of delivering health services to expand their services. This could extend beyond church organizations to facilities associated with resource projects. We stress that this is not about displacing the role of government, but following through on an existing government policy to increase the service-provision role of non-state actors.

One of the main instruments used by the aid program to support good institutions outside of Government is the Incentive Fund, which provides capital costs to a range of well-run organizations. While we saw and heard of several good Incentive Fund projects, there was also concern that some of the investments financed under the Incentive Fund were underutilized due to a lack of recurrent funds.

¹⁹ A 2007 review of the Health SWAP by the Independent Monitoring Review Group suggested that non-state health service providers should have direct access to health technical assistance. It is not clear whether this recommendation has been acted on.

We encourage the PNG and Australian Governments to consider more flexible and long-term ways to provide support to expand the work of strong institutions outside of the government sector.

A limitation of the Incentive Fund is that it will not support applications from the private sector. A more appropriate model in this regard is the Enterprise Challenge Fund (ECF), which provides for cost-sharing on private sector projects which are innovative and pro-poor and which might have trouble raising private financing. This would likely include microfinance, which is a priority for both governments, as well as agricultural and rural development projects. AusAID is piloting a regional ECF, in which PNG is participating. Subject to good results from this pilot, there would be a strong case for scaling-up this intervention.

There is strong support for an expanded volunteer and NGO program in Papua New Guinea. This was not only a theme articulated to us, but was one of the themes of the Prime Minister Somare's April 2009 speech. Volunteer and NGO programs help finance innovative work on neglected topics (for example, the work of CARE on extreme poverty in PNG), and help strengthen institutions. The aid program finances only about 50 volunteers to PNG, even though the unit costs are very low (about \$40,000 per volunteer), and most are placed outside of Port Moresby. We suggest consideration of a scaled-up volunteer and Australian NGO program in PNG, not only through expansion of the existing schemes, but also through their use in existing sectoral programs. If volunteers come at only a small fraction of the cost of consultants, one has to consider the former as substitutes for the latter. Already, we understand, consideration is being given to a new volunteer scheme to encourage Australian academics to serve at PNG tertiary institutions. Of course, any such initiatives would be subject to willing volunteers being available, and its success would require timely processing by PNG of visas, something which has been a problem in the past.

Existing government-to-government programs have strong support. Benefits of the SGP and other twinning programs which link Australian and PNG officers at the working level were widely remarked upon. We are not in a position to provide a comparative evaluation of the effectiveness of technical assistance provided through the private sector and government. However, it seems likely that each approach has its own strengths and weaknesses, and it is therefore appropriate that there should be, as there currently is, a mixed approach in which use is made of both channels.

6. Delivery mechanisms: summary of recommendations

6. Where non-state actors are performing effectively and/or showing potential, they should receive increased support. Mechanisms to do this include:
 - 6.1 A major initiative in the health sector to explore ways the aid program can assist the PNG Government to achieve its aim of delivering a greater proportion of health services through better-performing church-run facilities.
 - 6.2 Consider providing the Incentive Fund with the means to provide flexible and long term support to strong institutions outside of government beyond the provision of capital funds.
 - 6.3 An Enterprise Challenge Fund to provide cost sharing for private sector projects which are innovative and pro-poor (subject to success under the existing regional pilot).
 - 6.4 A scaled up volunteer and NGO program.

Section 7. Sector-wide approaches (SWAPs)

Consider and recommend: “measures to improve the effectiveness of sector-wide approaches [SWAPs] including possible alternatives.”

The aid program needs to deliver to the sectors which it supports not only funding but also management capacity, innovation and, most importantly, a capacity to demonstrate results. Section 3.2 has already highlighted the large recurrent funding gaps which undermine development in PNG. But it is far from the case that lack of funding is the only or even the most important binding constraint. We have also stressed the weaknesses in governance, and the capacity constraints which sometimes mean that funds allocated go unspent. The greatest leverage that the aid program can have is by demonstrating that results can be achieved in PNG. This demonstration impact will not only shore up support for the aid program, but will also and more importantly provide positive lessons which can be built on and scaled up.

There are a range of approaches to collaboration and alignment across the sectors where the aid program is active. Our consultations made clear that there are still important issues of government leadership, coordination and accountability to be addressed moving forward. However, there is a track-record that can be built on. While the aid program has stopped short of providing funds, earmarked or otherwise, into the PNG budget, considerable progress has been made in realizing the goal of joint implementation of the aid program.

- In the law and justice sector, a sectoral committee representing nine sectoral agencies determines how aid funds will be spent. The PNG Government has also put some of its own funds through this mechanism, though more recently has declined to do so.
- In transport, the aid program provides its funding (apart from for consultants) to a trust fund managed by the Department of Works. Aid funds are mainly allocated to the maintenance of an agreed number of the 16 national priority roads identified by the Government. Funds are paid by the Department to contractors following national procurement procedures, with sign-off by aid-

funded consultants. The aid program's engagement in the sector is guided by a government strategy document, the *National Transport Development Plan, 2006-2010*.

- In health, non-consultancy funds (about half of the total) are spent through the Health Sector Improvement Program (HSIP), which is administered by the National Department of Health to which provinces can apply annually. Funds cover a variety of non-salary recurrent funding needs in the sector. Provinces are responsible for procurement and payment.
- In basic education, about one-third of aid funds are disbursed through an imprest account under the control of the Department of Education.

While the sectoral interventions all differ in various ways, they are often referred to as SWAPs (sector-wide approaches) and certainly by international standards all have a number of SWAP characteristics. Even though funding does not pass through the central budget, key decisions are made by responsible government officers, and there is an integrated program of support, sometimes in support of a sectoral strategy.

The administration of the law and justice and health SWAPs are criticized on various grounds. By contrast, the aid program's engagement with the transport sector is widely acclaimed and held up as model for others to follow.

- In the case of the law and justice (L&J) sector, there are concerns around the appropriateness of the composition of the committee (the National Consultative Mechanism) which determines the allocation of aid to the L&J agencies. Some argue that bringing together the judicial and executive branches of government to manage and distribute a common funding pool is not appropriate. Concerns were also raised about the size of the Law and Justice Secretariat, and the number of advisers attached, not to any Department, but to the Secretariat itself. Both are issues that should be amenable to discussion and mutual resolution.
- In the case of health, most criticisms concern the lack of flexibility around the use of the funds. Some provinces complained that their funding priorities were ignored, even though they were in a better position to judge what was needed. Others advised that funds could not be reallocated to emergency needs such as the recent outbreak of cholera. There are also concerns that the financial regulations around spending are so tight that it is difficult for provinces to access the funding (ODE, 2009), though more recently HSIP provincial funding has increased (NEFC, 2010). Again, these are the sorts of issues that should be amenable to resolution.

The SWAP approach has also paradoxically given rise to the parallel, uncoordinated provision of funds, where transfers to provinces for the recurrent budget are involved. The SWAP approach is a natural one for providing support for core service-delivery areas, which lend themselves to sectoral programs rather than discrete projects. However, unless funding is directed towards a shared set of priorities under a common framework, duplication can be a problem. This is not a problem for the aid program in the transport or the justice sector (where engagement is confined to national agencies) but it is a problem in health, and education.

- *Health.* Provinces received through the budget a health function grant for non-salary recurrent expenses totalling K15 million across all provinces in 2008 (subsequently increased to K30 million). They also received through the donor-funded HSIP an additional K15 million in 2008 also for non-salary health recurrent expenses. The two funds are distributed separately. It is hard to see the point of having two separate funds for the same purpose, and easy to see the problems which having uncoordinated funds with different rules and procedures might give rise to.
- *Education.* A recent GoPNG report noted that some schools were receiving “two sources of government funding (national and provincial), [and] two sources of donor funding (one for teacher in-service and the other for school infrastructure maintenance).” (DLPGA, 2009, p.83) This year the aid program will start funding payments to school in lieu of funds lost due to the reduction in school fees. Schools will end up receiving, as compensation for reduced school fees, some payments from the budget and some payments from the aid program.

To avoid these difficulties, the aid program needs to avoid being a “half-way house” in the social sectors, and move either towards greater integration, or more independence. The aid program needs to move in either of two directions. One would be to integrate with the budget, to combine, for example, the HSIP with the health functional grant,²⁰ and the aid program’s education subsidy payments with those of the Government’s. The other would be to step back from providing dispersed sectoral support, and take over responsibility for a particular service delivery area, for example, provision of text books or drugs.

The advantage of the integrated approach is that it would help improve the accountability and effectiveness of GoPNG spending. It is well known that a significant portion of the functional grants received by provincial governments are diverted to other expenditure areas (NEFC, 2009). Designing a single set of accountability and monitoring mechanisms for both Australian aid and GoPNG funding would greatly help GoPNG with procurement and financial accountability and reporting in relation to its own funding, and would thereby provide significant leverage to and impact from Australian aid funding. Closer links with the recurrent budget would also help limit fungibility, that is, the risk that the more the aid program provides to a particular area, the less government does.

However, the integrated approach would be demanding for both sides. On the Australian side, it would require giving up the ban on providing funds, even if earmarked, into the PNG budget. Such a ban achieves little: what matters is the agreements in place on how the funds will be used, and how fiduciary risks are managed through monitoring, supervision, and strengthening of financial accounting and reporting systems. For example, in one possible approach aid funds could be disbursed as reimbursements against agreed budget expenditures, following agreed acquittal procedures. Open dialogue and negotiations between the two governments would allow a range of issues including fiduciary risk to be discussed and resolved to the satisfaction of both parties. On the PNG side, replacing parallel by integrated systems would mean allowing aid money to flow to the recurrent rather than the

²⁰ Under such an approach, the HSIP would presumably continue but only for earmarked payments (e.g. for HIV/AIDS treatment from the Global Fund).

development budget. This is not an issue with roads maintenance, since GoPNG spending on this is already on the development budget. But GoPNG spending on health and education function grants to provinces, as well as for school subsidies are all on the recurrent budget.

Moreover, there is no guarantee that an integrated approach, even if one can be forged, will work. Placing greater reliance on government systems may lead to implementation problems. The aid program used to directly procure and distribute (to the district level) essential drugs for health centres. In 2005, it transferred this process to the Government, and the distribution of drugs worsened markedly. In the roads sector, the aid program is now making greater use of government systems but at the cost of greater delay in issuing and processing contracts.

The alternative approach of the aid program taking over the responsibility for a discrete area of service delivery, say, drugs or textbooks, also has much to recommend it. In the transport sector, though there is an overall financing plan, the aid program, rather than contributing a percentage to the financing of maintenance of all priority roads, directly takes responsibility for the maintenance of a certain number of roads. Though note that this doesn't mean that decisions about these roads are made in isolation by AusAID. In fact, much of the work is done by the Department of Works, though with special assistance and oversight from the aid program. The disadvantage of this approach is reduced leverage. The advantage is increased accountability for the aid program, and the opportunity it allows to package management with financial assistance. What would be important if this route is taken is that a sensible division of labour be established between the aid program and the concerned department, so that duplication is minimized.

A pragmatic approach is required, and different approaches might be adopted in different sectors to maximize the impact of aid. The right balance of reliance on government systems, and on managing contractors will likely vary from sector to sector. A formulaic approach, say based on invocation of Paris Declaration principles, is unlikely to be of much use. While the Paris Declaration principles – of ownership, alignment, harmonization, results-based management and accountability – are of universal validity, the Declaration can add most value for poor countries with relatively good or at least improving governance and with a large number of donors. As we have documented in this report, the situation in PNG is quite different, and adaptive, home-grown solutions will need to be found to improve aid effectiveness.

In the cases of health and education we do recommend that greater integration of aid and recurrent budget expenditures be attempted. This would be consistent with, though an acceleration of, the current thrust of the aid program. It would potentially reduce duplication, and increase impact.

In the case of transport, the aid program may need to take a more "hands-on" approach to ensure current capacity constraints are relieved. While the aid program's engagement with the transport sector is widely acclaimed, it is not delivering effectively, as shown by the limited disbursement of existing funds. The aid program should consider measures to accelerate implementation. Options for negotiation between the two Governments could include the provision of aid-funded in-line managers, and a streamlining of procurement procedures to expedite contracting.

7. Sector-wide approaches: summary of recommendations

- 7.1 A programmatic approach is appropriate for providing support to core areas of service delivery, and should be persevered with. The problems that have arisen (and that will continue to arise) need to be resolved on a sector-by-sector basis. A pragmatic approach is needed: there is no one size which fits all sectors.
- 7.2 We suggest a review of administrative arrangements in the law and justice (L&J) sector for the allocation of aid and support the review underway of the size and role of the L&J Secretariat.
- 7.3 There is a risk in the primary health and school education sectors of the aid program creating parallel uncoordinated and duplicative systems for provincial and facility recurrent funding. We support reforms which would lead to the greater integration of aid and budget funds, and therefore greater impact, for example through aid funding of provincial function grants. Open dialogue and negotiations would be needed to resolve several outstanding issues, including the management of fiduciary risk. Failing successful resolution of these issues, the aid program should consider taking on discrete service delivery tasks within key sectors.
- 7.4 In the case of the transport sector, the aid program may need to take a more “hands-on” approach to ensure that current capacity constraints which are blocking the expenditure of allocated funds are relieved.

Section 8. The Development Cooperation Treaty

Consider and recommend: “any necessary changes to the goals and objectives of the Development Cooperation Treaty to ensure Australia’s aid has high development impact and is increasing in the priority areas of the PNG-Australia Partnership for Development, namely transport infrastructure, basic education, health, economic and public sector management, statistics, HIV/AIDS, higher education and law and justice.”

8.1 Analysis

Australia has bilateral Agreements with a number of the major recipients of its aid. These Agreements typically cover consultation, taxation arrangements, and local counterpart funding responsibilities.

The 1999 Australia-PNG Development Cooperation Treaty is distinct in four ways:

- There is an emphasis on the aid being “jointly programmed” (Article 4).
- There is a commitment by Australia to provide 5-year indicative funding commitments, to be reviewed every three years (Article 6(1)).
- A benchmark system is established to “influence the level and allocation of funding of the development cooperation program” (Article 8).
- An Incentive Fund is established: to “allow all levels of Papua New Guinea Government and community organizations to receive direct funding for the delivery of development cooperation” and “[to] support those groups with a demonstrated performance record and innovative development cooperation proposals within agreed priority areas.” (Article 7).

While the notion that aid should be jointly programmed seems as relevant today as when the DCT was signed, there are question marks over the other distinctive commitments of the DCT.

The practice of Australia providing 5-year indicative funding commitments has lapsed. A 1999 joint press release from the PNG and Australian Foreign Ministers (Downer and Yaki, 1999) indicated that Australia would provide a maximum of \$300 million of aid annually for aid in Papua New Guinea from 2000 to 2003, but we are not aware of any subsequent forward commitments at the aggregate level. Three of the Partnership for Development schedules provide forward commitments covering half of the aid program.

As discussed in Section 5, the DCT performance benchmark system hasn't worked, and has also lapsed. As also discussed in Section 5, the Partnership for Development provides a new performance benchmark system, similarly focused on budget allocations and performance targets.

The elevated treaty status given to the Incentive Fund does not appear warranted. The Incentive Fund continued until 2009, though, after an initial period of supporting both government and non-state actors, post-2005 only supporting non-state actors. A new phase has just commenced. It is not obvious why the Incentive Fund should be the only specific aid initiative mentioned in the Treaty. It is a relatively small amount of the total aid program (less than 5%). As noted in Section 6, while the principle of backing winners is sound, it is not clear why the private sector should be excluded, and why support should only be provided through capital investments.

Issues have also been raised concerning tax treatment under the Treaty. The PNG Department of Foreign Affairs and Trade raised with us the issue of tax-free status for firms employed to implement the aid program. Concerns were raised as to whether this tax-free status was warranted for profit-making firms, and whether it resulted in taxes being paid in Australia rather than PNG. In the short time available to us we were unable to pursue this issue, beyond noting that the tax treatment in the DCT appears to be broadly consistent with that in other bilateral development cooperation treaties Australia has entered into. We recommend that a joint review be undertaken to determine: (i) whether the current tax treatment of agencies involved in implementing the aid program is consistent with the actual provisions of the DCT; and (ii) whether the provisions of the DCT are consistent with common tax practice in relation to donor activity in PNG and internationally. The answer to (i) would provide a basis for short-term policy in this area; the answer to (ii) would inform any review of these provisions.

8.2 Recommendations

At least four options can be considered in relation to the future of the DCT:

- Neither the DCT nor its administrative arrangements are amended.
- The DCT is retained, but its administrative arrangements are amended.
- The DCT is revised.
- The DCT is replaced by an Economic Cooperation Treaty.

Any decision on which is the preferred option must first consider what should be done in relation to the separate issues raised above of forward commitments, performance benchmarks, the Incentive Fund, and tax treatment. Providing forward commitments and having performance benchmarks is consistent

with the Partnership for Development approach, and with international (Paris/Accra) agreements. Giving treaty status to the Incentive Fund seems unnecessary, but innocuous. The tax issue requires further review.

At a minimum, the administrative arrangements for the DCT need to be updated. Even if both parties accept the current provisions of the Treaty, new five-year indicative commitments would need to be agreed on, and the Partnership for Development schedules adopted as the new benchmarks for the Treaty.

There may also be a need to revise the DCT. If the two Governments decide a revision of tax treatment is needed, or that five-year indicative commitments should no longer be provided, or that there is some other matter they wish to insert in the Treaty, then a revision of the DCT would be required. One option would be to standardize the DCT by taking out its distinctive clauses so that it is similar to Australia's other development cooperation agreements.

There is also a case for replacing the DCT by an Economic Cooperation Treaty. This would cover issues relating to aid, but also trade, migration, and possibly others. Compatibility with PACER-plus negotiations would need to be assured. The European Union Economic Partnership Agreements could perhaps provide a model.²¹ Developing an Economic Cooperation Treaty would send a strong signal that the relationship between Australia and PNG is maturing and diversifying, away from one which is aid-dominated, towards one which is multi-faceted and increasingly integrated, away from a traditional donor-recipient relationship towards a partnership of equals.

In closing this section, we note that overall the DCT has little influence on the delivery of the Australian aid program to PNG. We commend the approach taken in our terms of reference, with its focus on aid effectiveness, and positioning of changes to the DCT as just one issue among several which need to be addressed if the effectiveness of the Australian aid program is to be enhanced.

8. Development Cooperation Treaty: summary of recommendations

- 8.1 *To update the DCT and ensure adherence, adopt the Partnership for Development schedules as Treaty performance benchmarks, and return to the provision of multi-year indicative funding commitments by Australia.*
- 8.2 *Review and resolve the issues raised by the Government of PNG in relation to taxation of companies involved in delivering the aid program before a final decision is made on the revision of the DCT or any successor agreement.*
- 8.3 *Consider replacing the Development Cooperation Treaty by an Economic Cooperation Treaty.*

²¹ In 1999, Australia and Fiji signed an agreement on Trade and Economic Relations. Note, however, it has no aid provisions.

Section 9. Exit strategy

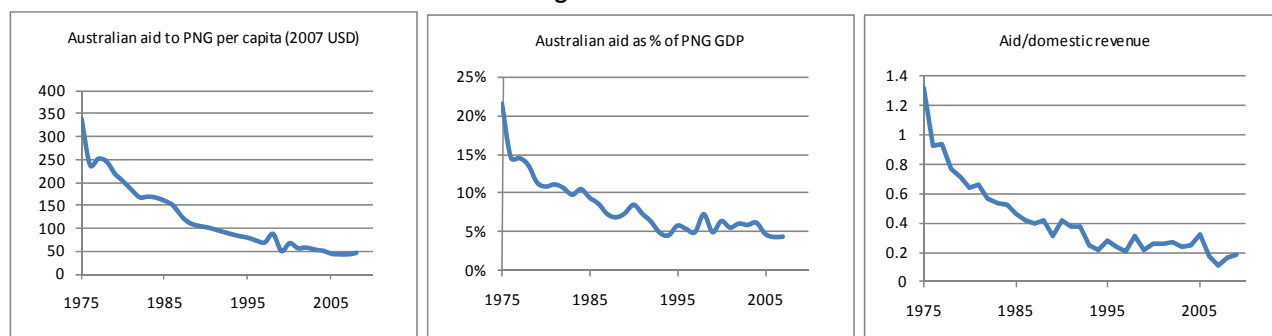
Consider and recommend: “a realistic strategy and timeframe for PNG’s progressive graduation from Australian official development assistance, and the actions required of both governments to achieve this. The strategy will give effect to the GoPNG’s decision to gradually reduce development assistance to mutually agreed levels in future.”

9.1 Analysis

Papua New Guinea has recently announced that it wants to agree on an exit strategy in relation to Australian aid. This strategy is being pursued by the Government of PNG in order that the country can be responsible for its own destiny and development rather than continue to rely on foreign aid. However, the Government is supportive of a gradual implementation of the strategy over an agreed period of time. In an April 2009 speech delivered in Canberra announcing the exit strategy decision, Prime Minister Somare said that: “Resources will initially be redirected to identified sectors to achieve better development outcomes with a view to eventually phasing out the ODA.” He continued: “This will be done in ways that does not prejudice Papua New Guinea’s development effort or without destabilizing our national budget.”

PNG has already successfully and significantly reduced PNG’s reliance on total and Australian aid. Not only has Australian aid to PNG fallen sharply in real terms since independence (Figure 4), but PNG reliance on Australian aid has fallen even more dramatically. Figure 13 traces over time Australian aid to PNG since independence expressed both on a per capita basis and as a percentage of GDP. It also presents the ratio of all aid to total domestic government revenue. By all these measures, one can see PNG has already taken on “more responsibility for our national development,” to use the language of the PNG Prime Minister from his April 2009 Canberra Speech, indeed much more. At the time of independence, Australia used to provide PNG with \$US350 per person. Now it is only \$US50. At the time of independence, Australian aid was equivalent to 20% of PNG’s GDP. Now it is less than 5%. At the time of independence, Australian aid was worth more than double PNG’s domestic revenue. In the last couple of years, aid for the first time fell to less than 20% of PNG government revenue.

Figure 13 Australian aid to PNG, per capita and as a percentage of PNG GDP, and total aid as a fraction of PNG domestic government revenue



Source: OECD DAC, Batten (2009), PNG Budget Documents (various years).

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Note: Australia's aid as a percentage of PNG's GDP is measured using current US\$, and the ratio of all aid to domestic revenue is measured using current Kina.

Unlike at independence, trade is today much more important than aid in the PNG-Australia relationship. In 1975, PNG imported K161 million of goods from Australia and exported K47 million. Total trade with Australia was therefore only K210 million, and with the Kina trading at par with the Australian dollar at the time of independence about equal to the value of aid from Australia. By 2008, PNG imported K3.5 billion of goods from Australia and exported K6.8 billion of goods. Total trade with Australia was therefore K10.2 billion, or more than 10 times the value of the aid program. Thus, since independence, PNG's trade with Australia has gone from being on par with aid to being worth 10 times aid.

This reduction in Australian aid has been a deliberate and mutually agreed strategy, carried out over the last 30 years, but based on premises which have not come to fruition. The initial strategy of "a steady reduction in the real value of Australian aid" (Jackson Review, 1984, p. 163) can be traced back to at least the Crawford Report of 1980, which "drew attention to both governments' objectives of achieving a gradual but predictable real decline in aid over the longer term." (Jackson Review, 1984, p. 160). The recommendation of the Crawford Report was that Australia's aid should decline at a real rate of 5% per annum. Eventually, a reduction rate of 3% was agreed on in the mid-eighties, and realized. But all of this was on the assumption that PNG would grow and develop. It was certainly not foreseen that PNG's per capita income would stagnate.

International experience is useful to provide a guide for aid exit strategies. Those countries that have completely or largely graduated from aid, including Korea, Taiwan, Singapore Malaysia, and Botswana, have done so on the basis of success. Their aid receipts started falling once they were experiencing sustained growth, and had achieved basic human development benchmarks, such as universal education. While PNG has experienced growth in recent years, it is too early to say that this will be sustained, and PNG is a long way off from achieving basic human development benchmarks, such as the MDGs. It is unlikely that any other donor will step forward in a major way should Australia exit. There is a risk that PNG would become an "aid orphan" rather than an "aid graduate." We received strong feedback from interlocutors on the PNG side on the need for caution in further reducing reliance on Australian aid.

There are benefits for PNG from increasing integration with Australia. A more integrated relationship with Australia will not necessarily entail less aid. As PNG interacts with Australia on an increasingly wide range of issues, it is likely that there will in fact be upward pressure on aid. This has been the recent experience with Australian aid to Indonesia for example. From this perspective, the aim should be to grow trade with and investment from Australia, rather than to reduce aid.

PNG already receives less aid than one would expect for a country of its size and income level, and appears to be successful in diversifying its aid portfolio away from Australia (Section 1.2). Even countries with much higher levels of income and better human development indicators than PNG choose to receive significant amounts of aid. Countries use aid to provide access to new ideas and reforms. PNG's

nearest neighbour, Indonesia, though having twice the per capita income of PNG chooses to receive billions of dollars in aid in order to get access not only to concessional resources but also new ideas.

Australia is willing to finance a temporary increase in aid to PNG. This has already been signalled in the Partnership for Development. The global Australian aid program is expanding rapidly. Total aid (worldwide) from Australia is expected to reach about \$8 billion in 2015, up from \$4 billion currently. PNG is Australia's second biggest recipient of aid (after Indonesia), and it is hard to believe that Australia's aid program could double without a significant increase for PNG. The Review Team was given an indicative figure for Australian aid to PNG of \$650 million by 2015.

9.2 Recommendations

All of the above analysis, taken together, suggests a two-phase strategy, short-term and long-term.

The substantial reduction in aid reliance already achieved to date gives PNG the space to accommodate a temporary increase in the aid program. While the aspirations embodied in PNG's desire for an exit strategy from aid are sound and welcome, the phasing of any such strategy will be crucial to its success. As noted in Section 3.2, and illustrated by Figure 12, it is possible that PNG will face a difficult budgetary situation in the coming years prior to the commencement of LNG tax revenues which, we were informed, will not be till around 2018. Moreover, aid supplements not just internal financial resources but technical expertise and capacity which are going to be in high demand in the coming years. For these reasons, the Australian aid program has an especially important role to play in the run-up to the LNG project. It is beyond the scope of our terms of reference to comment on what an optimal level of Australian aid to PNG would be. However, there is certainly scope, given the progress achieved to date in reducing reliance on aid, to accommodate a temporary real increase as part of an overall aid exit strategy.

Longer term, PNG should target a falling ratio of aid to revenue over time, based on benchmarks relating to growth and the MDGs being obtained. A falling ratio of aid to revenue is consistent with PNG's goal of an exit strategy, and with obtaining more control over its development destiny. Even with some increase in the aid budget over the coming years, by 2020, with the LNG project generating upwards of K1-2 billion in revenue for government a year, and with solid GDP growth, the ratio of aid to revenue should be lower than it is today. Today, Australian aid is about 13% of total PNG revenue (from domestic sources and aid combined). Indicative analysis suggests that one target would be an Australian aid to PNG revenue target of less than 10% by 2020, with a further significant decline projected by 2030. Such an approach would allow an early increase in aid-to-revenue prior to the flow of significant LNG tax revenues – as Australia scales up its aid program, and as PNG revenues grow more modestly. It would also ensure a more-than-offsetting fall – as Australian aid stabilizes and PNG revenue increases rapidly with LNG proceeds. Any target selected should be reviewed periodically, say, every three or five years. Graduation should be grounded in success. Continued adherence to aid reduction targets should be

dependent on PNG sustaining good economic growth, and making progress on human development indicators.

9. Exit strategy: summary of recommendations

9. To implement its exit strategy, PNG should target a falling ratio of aid to revenue over time (for example, to reduce Australian aid to below 10% of revenue by 2020) dependent on benchmarks relating to growth and the MDGs being achieved. However, a phased approach is needed. The substantial reduction in aid reliance already achieved to date gives PNG the space to accommodate a temporary increase in the aid program, particularly up to the commencement of significant LNG revenues in around 2018, and before which PNG's budgetary situation could be difficult.

Section 10. Transparency and accountability

Consider and recommend: "appropriate measures including regular reporting and exchange of information to improve transparency and accountability for results from development expenditure in PNG."

10.1 Analysis

Developing mechanisms to improve reporting, transparency and accountability are critical for any effort to improve aid effectiveness. Effective reporting mechanisms reduce tension between donor and recipient. Where reporting is weak, suspicion and fear tend to creep in and weaken the relationship.

The need to improve reporting and in particular the exchange of information is not new for the aid program. The 2004 DCT Review had as its first recommendation "constructive engagement – officials of both governments need to work cooperatively across all areas of the aid program and at all levels." (Lepani, Morris and Tuioti, 2004, p.1). Given the evidence from our consultations, we have little reason to believe that the level of constructive engagement has improved between 2004 and today. Unless resolute efforts are made to repair the poor level of dialogue, it is difficult to see how the aspirations embedded in the DCT and in the Partnership for Development can be realized.

There is a shared commitment to act. Australia has signed and PNG has endorsed the Aid Transparency Initiative (<http://aidtransparency.net/>). The Paris Declaration and the Accra Agenda for Action also include commitments to transparency and accountability. We welcome the recommendation of the Steering Committee for this Review that it be made public.

Improvements in the reporting of information and exchange of information are needed in multiple dimensions. Gaps can be observed at both the micro and macro level (from the way individual consultants report to the way the overall program is managed), and both horizontally and vertically, within the Government of PNG and between the Governments of PNG and Australia. Dialogue needs to extend beyond the officer level to include strategic but sufficiently regular and sustained discussions at the ministerial level, and between ministers and officials.

A greater sense of realism is needed. Accountability requires objectives be set at the appropriate level. In setting objectives for the aid program, it needs to be recognized that the aid program is providing a small and declining proportion of the total resources available to PNG, that GoPNG is not very interested in policy dialogue with Australia on key issues such as expenditure allocation, and that Australia has limited leverage over GoPNG policy and expenditures. Any influence Australia perhaps once enjoyed through the aid program is sharply diminished in light of PNG's resources boom, and its modest appetite for additional aid. Even in the priority sectors where aid funds are concentrated, such as education, health and roads, Australia provides less than 20% of total GoPNG resources to these sectors. For example, it is 9% of GoPNG spending in basic education. While we support a robust dialogue at the political level over the alignment of PNG budget resources with its own priorities and Partnership for Development agreements, the evidence suggests that one should be careful not to over-estimate Australia's influence.

We have a number of suggestions, first for both Governments, then for the Government of Papua New Guinea, and finally for the Australian Government on the issues of transparency and accountability.

10.2 Recommendations for both governments

The Partnership for Development schedules provide a useful tool for transparency and accountability, but are undermined as accountability tools because of their large funding gaps. As suggested in Section 5, priority needs to be given to development by GoPNG of a Medium Term Expenditure Framework (MTEF). Major Partnership schedules would need to be revised once the MTEF is in place.

Lower-level, intermediate goals are also needed for the aid program. Given the limited influence of the aid program over PNG resources and policy, the Partnership approach needs to be complemented by more concrete and achievable goals for the aid program itself. Appropriate, realistic goals could be (depending on the focus of the program): maintenance of x km of national roads; distribution of text books to all children in grades x to y; enhancing the value and performance of health functional grants to provinces; and so on. Reducing the number of its activities within each sector, and pursuing a unchanged set of goals over a number of years would be a necessary prerequisite for such an accountability system to take root within the Australian aid program to PNG.

This calls for a more, not less strategic approach to the aid program. Operating in what we have described as a difficult environment, the aid program needs to justify its existence by showing it is able to provide essential services to PNG citizens, that it is able to support better performing institutions in PNG to do more, and that it is able to innovate and experiment. How best the aid program can do this raises a number of difficult questions, and in this report we have certainly not been able to provide all the answers. For example, in the health sector alone we have noted the case for aid support for expansion of church health services, greater use of facility grants, and integration with provincial functional grants. None of these would easy to implement, but any one of them, if tried and found

successful, would more than justify the continued expenditure of aid funds. At the moment, there is a failure to articulate possible mid-level goals for the aid program, and therefore a lack of strategic focus.

The aid program should model through its activities the value of transparency and accountability. Some have suggested the aid program take a “payments for result” approach with, for example, payment of \$x per additional child enrolled (Chand, 2007). We are not convinced of the merits of such a “hands off” approach in the PNG environment, but we agree with the principle that the aid program should demonstrate the benefits of greater transparency and accountability. Thus for example aid payments to schools could be published in the newspaper, and school noticeboards could be required to publish both the receipt of funds and the use made of those funds. Adoption of such practices by the aid program would encourage government departments and provinces to follow suit.

The aid program can help improve transparency and accountability for government as well as aid spending. For example, the aid program has helped generate data on the percentage of all priority roads (no matter how funded) in good condition. It has also helped the NEFC generate important data on how much provincial spending is going to front-line services. Continuing to support work on monitoring volumes, spending, and outcomes from recurrent spending should be a high priority.

There seems to be a need on both sides to adjust reporting expectations and modes to take account the greater alignment of the aid program with GoPNG systems. For example, the Department of National Planning and Monitoring (DNPM) might expect AusAID to report directly to it on the aid program’s sub-national work, whereas AusAID, since it is supporting the Government’s own Provincial Performance Initiative, might expect the Department of Provincial and Local Government Affairs to report on AusAID’s support as part of its own reporting to DNPM. There is no right way these joint reporting responsibilities should be discharged. It is simply a matter of working out agreed procedures based on open discussion.

Both governments could do more to publicize the success stories of the aid program. This would help build support for the aid program, and provide valuable lessons.

Making this Review public would promote public discussion of the aid program, and would be consistent with existing commitments to improved transparency.

A small consultative council advising both Governments in relation to the Australian aid program to PNG could be a useful and practical transparency and accountability mechanism. The Australia-PNG Business Council and the Business Council of PNG recommended to the 2009 Australia-PNG Ministerial Forum the establishment of “a Development Assistance Delivery Council (DADC) to assist in identifying, structuring and delivering development projects to achieve the most effective and efficient outcomes.” The DADC would “consist of representatives of the Australian Government, the PNG Government and the Business Councils.” While we would be reluctant to give an elevated role only to the representatives of the private sector, we do think a useful role could be played by the establishment of a small advisory council to the aid program with broader representation. Such a body could perhaps meet at the time of the

Ministerial Forum and provide feedback and advice to both Governments from both Australian taxpayers and PNG stakeholders. It would need to be small to be effective, but could include members from not only the private sector, but also NGOs and academia.

10.3 Recommendations for the Government of Papua New Guinea

The investment of time, effort and political capital to improve government leadership and coordination of the aid program is especially important given the many stakeholders in the aid program. Such an investment will pay rich dividends in maximizing returns from what is still a large and significant resource. In particular, the Department of National Planning and Monitoring should avoid assuming management responsibilities for sectoral projects and programs and focus its efforts on providing strategic guidance and oversight to the aid program.

The practice of bringing together donors on an annual basis has fallen into disrepair. Given the increased diversification of aid donors to PNG in recent years, a well- functioning, simple, results-focused donor coordination mechanism is highly recommended.

We commend the work done by the Government of PNG to establish an online aid database. International experience suggests that such databases can be important instruments for transparency and accountability.

10.4 Recommendations for the Government of Australia

More balanced systems of audit, monitoring and evaluation would enable AusAID to establish not only that funds have not been misused, but that they have been used effectively. AusAID places a high importance on ensuring that funds are not lost to corruption, but instead are used for the purposes for which they are intended. The focus is often on the acquittal of funds: that is, whether it can be shown that goods or services were purchased in line with the intended purposes of different programs. But the purchase of goods and services is only one link in the service delivery chain. Better monitoring and evaluation of the service delivery chain in its entirety would enable more accountability, and also would also contribute to the evidence base for policy dialogue.

AusAID should make more data about the aid program available on its website. At the moment on the PNG page, one cannot get a sense of what current programs are, and what the current year's aid budget is spent on.

An increasing proportion of the greatly expanded number of AusAID staff in PNG is paid for out of the aid budget. It is a global practice for AusAID to charge national staff costs to the aid program they help administer. But it is unclear why some Australian aid staff, for example the provincial liaison staff, are charged to the aid program. A more transparent and shared approach to the question of which AusAID staff are charged to the aid program is warranted.

10. Transparency and accountability: summary of recommendations

Recommendations for both Governments:

- 10.1 *The Partnership for Development schedules promote accountability, though their funding gaps need to be filled (see Section 5).*
- 10.2 *Lower-level, intermediate goals, which the aid program can be realistically expected to influence, are also needed for the aid program.*
- 10.3 *Aid program activities should embed and thereby model principles of public transparency and accountability.*
- 10.4 *Reporting expectations and modes need to be adjusted to take account of the greater use by the aid program of GoPNG systems. Stand-alone reporting by AusAID to the National Department of Planning and Monitoring is less relevant in such a context.*
- 10.5 *Both Governments could do more to publicize the success stories of the aid program.*
- 10.6 *A small consultative council advising both Governments in relation to the Australian aid program to PNG could be a useful and practical transparency and accountability mechanism.*
- 10.7 *Make this Review public.*

Recommendations for the Government of Papua New Guinea:

- 10.8 *Strengthened government leadership and coordination of the aid program by the PNG Government is critical for improved aid effectiveness. In particular, the Department of National Planning and Monitoring should avoid assuming management responsibilities for sectoral projects and programs and focus its efforts on providing strategic guidance and oversight to the aid program.*
- 10.9 *Annual meetings with donors to promote effective dialogue and address aid effectiveness issues deserve priority attention.*

Recommendations for the Government of Australia

- 10.10 *Greater use of monitoring and evaluation, extending beyond audit, would enable AusAID to establish not only that funds have not been misused, but that they have been used effectively, and provide a stronger evidence base for policy dialogue.*
- 10.11 *AusAID could make much more data about its PNG aid program available on its website.*
- 10.12 *A more transparent and shared approach to the question of which AusAID staff are charged to the aid program is warranted.*

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Annex 1: Review consultations

Government of PNG

Hon Arthur Somare, MP, Minister for Public Enterprise

Hon Paul Tiensten, MP, Minister for National Planning and District Development

Hon Sasa Zibe, MP, Minister for Health and HIV/AIDS

Hon James Marape MP, Minister for Education

Hon Peter O'Neill, MP, Minister for Public Service

Department of Community Development

Joseph Klapat, Secretary

Molly Willie, Deputy Secretary, Policy Division

Maryline Kajoi, Office for Advancement of Women

Department of Education

Luke Taita, Secretary (Acting)

Damien Rapesa, Deputy Secretary, Education Standards

Godfrey Rua, First Assistant Secretary, Curriculum Senior officials

Department of Finance

Steven Gibson, Deputy Secretary

Department of Foreign Affairs and Trade

Michael Maue, Secretary

Charles Lepani, PNG High Commissioner to Australia

Lucy Bogari, Deputy Secretary, Policy

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Department of Health

Clement Malau, Secretary

Mark Malaudu, Deputy Secretary

Department of Justice and Attorney General

Lawrence Kalinoe, Secretary

Department of National Planning and Monitoring

Joseph Lelang, Secretary

Ruby Zariga, Deputy Secretary - Policy

Joseph Demas Deputy Secretary - PIP

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Review of the PNG-Australia Development Cooperation Treaty (1999)

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Annex 2: Terms of reference

10th June, 2009

Agreed Terms of Reference

Review of the PNG – Australia Development Cooperation Treaty (1999)

Background

The Joint Declaration of Principles Guiding Relations Between Australia and Papua New Guinea (1987) forms the basis for the Treaty on Development Cooperation (DCT). Specifically, in the DCT the 8th, 9th and 16th Principles are translated into development cooperation arrangements between the two countries.

Following this Joint Declaration, a Treaty on Development Cooperation between the Government of Australia and the Government of Papua New Guinea was signed in 1989 and reviewed and replaced in 1999. This new Treaty on Development Cooperation was signed by then Prime Ministers Howard and Morauta on 7 October 1999 and came into effect on 31 July 2000. The Treaty sets out the principles, objectives, management and administrative arrangements under which Australia and PNG deliver a joint development cooperation program.

The DCT guides all development cooperation between PNG and Australia, including the joint Development Cooperation Strategy (DCS) 2006-2010, which documents the broad principles and strategies of the Australian assistance program. A Joint Aid Review was commissioned by the two Governments and reported in 2004 on appropriate management arrangements and directions for the development cooperation program. Findings of this review were reflected in the joint DCS. It was envisaged that a mid-term review of the DCS would be conducted in 2008, however, this review was not undertaken.

Recent developments in bilateral relations have given rise to changed objectives and principles for engagements. In March 2008 Prime Minister Rudd, during a visit to PNG, announced the Port Moresby Declaration on the principles for Australian engagement in the Pacific region. The Port Moresby Declaration included a proposal for bilateral Partnerships for Development. Prime Ministers Somare and Rudd signed the PNG – Australia Partnership for Development in Niue on 20 August 2008. The first five implementation schedules under the Partnership were agreed by Ministers at the 19th PNG/Australia Ministerial Forum in Brisbane in June 2009.

In meetings with Australian Prime Minister Rudd in Canberra on 28 April 2009, PNG Prime Minister Somare set out PNG Government thinking on the need to modify development cooperation arrangements including modalities for delivery of Australia's ODA to PNG in order to better reflect PNG's long term development aspirations, including gradual phasing out of the development assistance from Australia over time. Prime Ministers Rudd and Somare therefore agreed that the two Governments should undertake a review of the current Development Cooperation Treaty, and directed that Ministers endorse Terms of Reference for the review at the 19th PNG/Australia Ministerial Forum in Brisbane in June 2009.

Scope

The review is to consider and recommend how Australia's aid can most effectively contribute to PNG's current, medium and long-term national development priorities.

The review should take account of current Australian and PNG development policies and strategies, as set out in the PNG Government's forthcoming National Strategic Plan 2010-50 and Long Term Development Strategy 2010-2030, the PNG-Australia Development Cooperation Strategy 2006-2010, the 2008 Port Moresby Declaration and the 2008 PNG – Australia Partnership for Development.

Other international development commitments to which Papua New Guinea and Australia are signatories e.g. Millennium Declaration setting out the Millennium Development Goals and the Pacific Plan, should also be taken into consideration.

The review should consider and recommend an appropriate role for Australia's development cooperation program in relation to new and emerging issues including, but not limited to, climate change, HIV/AIDS, trade and private sector development and the national development opportunities presented by growth in the PNG economy.

The review should also analyse and take account of current international and PNG thinking on aid effectiveness and best practice in jointly managing development cooperation programs, in order to recommend as necessary changes to the management and administrative arrangements for the development cooperation program. Key documents in this respect will include the Paris Declaration on Aid Effectiveness, Accra Agenda for Action and the PNG Commitment on Aid Effectiveness. A review of the implementation of the 2004 Joint Aid Review should form an important starting point for this work.

The review should consider and recommend to governments:

- an appropriate future balance in the use of different forms of aid, including training and technical assistance, capital investments and direct support for service delivery and community development. In doing so, the review will identify the recent and current levels of aid expenditure under different forms of aid;
- mechanisms to progressively and substantially increase Australian ODA investment in economic and social infrastructure in Papua New Guinea;
- an appropriate balance between assistance to the national government and to provinces, districts and local level governments;
- any additional measures to ensure that Australia's aid delivery is aligned with and supports PNG budget priorities, promotes fiscal sustainability and is reflected in PNG budget documentation;
- appropriate mechanisms for delivery of Australian ODA, including the local and international private sector, volunteers, civil society and government-to-government programs;
- measures to improve the effectiveness of sector-wide approaches including possible alternatives.

The review should consider and recommend any necessary changes to the goals and objectives of the Development Cooperation Treaty to ensure Australia's aid has high development impact and is increasing in the identified priority areas of the PNG-Australia Partnership for Development, namely transport infrastructure, basic education, health, economic and public sector management, statistics, HIV/AIDS, higher education and law and justice.

The review should consider and recommend a realistic strategy and timeframe for PNG's progressive graduation from Australian official development assistance, and the actions required of both governments to achieve this. The strategy will give effect to the GoPNG's decision to gradually reduce development assistance from Australia to mutually agreed levels in future.

The review should consider and recommend appropriate measures including regular reporting and exchange of information to improve transparency and accountability for results from development expenditures in PNG.

Outputs

It is expected that the review process would produce these key outputs:

- (1) A report from an independent review team outlining the findings of the review and making recommendations for consideration by both governments
- (2) A record of agreement between the two governments outlining their decisions in relation to the recommendations of the independent review team
- (3) A revised treaty on development cooperation reflecting the agreement of the two governments on the recommendations of the independent review team.

Methodology and Timing

The review would be done by an Independent Team comprising one nominee of the Australian Government, one nominee of the PNG Government and a mutually agreed third person. Both Governments should nominate suitable candidates for the independent review team.

The review team will report to a Joint Steering Committee of Senior Officials of both Governments which would meet regularly throughout the process and report to both Governments.

The Steering Committee will convene within two weeks of the endorsement of the review Terms of Reference by Ministers, and be responsible for submission to both Governments of a final report and revised terms of the Development Cooperation Treaty.

The Steering Committee will be supported by a small Secretariat of one or more officials from each Government who would undertake much of the background research, analysis, consultation and drafting under the guidance of the Steering Committee. Both Governments will nominate individuals to form the Secretariat at the first meeting of the Steering Committee. The Secretariat will ensure that appropriate consultation with central and sector agencies takes place.

The independent report should be completed by the end of March, 2010 and report to the Steering Committee.

As outlined above, the review will commence as soon as possible after agreement to the Terms of Reference by Ministers.

Timing of the completion of the review will be dependent on the completion and PNG Government approval of the Long Term Development strategy (2010-2030). Nevertheless it is proposed that the Steering Committee report to the 2010 Ministerial Forum.