



Strategy and Program Assessment

Document Stage: Final
March 2006

PNG: Governance in Papua New Guinea – A Thematic Assessment

Governance in Papua New Guinea – A Thematic Assessment

1. Papua New Guinea (PNG) is a country with many potential sources of economic growth¹, yet investment and development continue to be constrained by the quality of governance², which has been deteriorating gradually since the late 1980s. The effects of this are most visible in the declining standard of basic services, serious law and order problems, and institutional weaknesses that allow corruption to thrive. Decisive action is needed to build strong public expenditure and accountability institutions to support PNG's long-term stability.

2. Governance lies at the core of PNG's development challenges. It is the subject of extensive discussion and general commitments throughout the Government's *Medium Term Development Strategy (MTDS) 2005 – 2010*³, and has been the core focus of its reform efforts over the past four years. The MTDS was developed with substantial government input and enjoys a level of ownership within government that was not evident with previous such development plans. As such, ADB and PNG's other major development partners are committed to embracing the MTDS as the basis for future engagement and support.

3. Achieving good governance is not an easy task in a country characterised by extreme linguistic diversity, a fragmented clan-based social structure whose obligations are carried over into the political arena, and a fragile sense of nationhood. PNG's political system encourages instability and the accrual and dispensing of largesse by politicians; the bureaucracy has become highly politicized; policy-making is often ad-hoc in nature; corruption is endemic; and inter-governmental collaboration (between national, provincial, and local levels) doesn't work. A pervasive consequence of these factors has been that both politicians and public servants usually have very short-term goals. In short, the conditions for sustained attention to and delivery of a medium term plan barely exist.

4. The current government is enjoying an atypical period of stability, having been in office since 2002. The benefits of this stability are evident in the governance reforms that have so far been introduced and sustained. Nevertheless, the achievements are fragile. By and large, PNG's policy and legislative frameworks are strong, but the Government continues to struggle with compliance and implementation. Although there are local champions for intensive reform aimed at improving governance, a critical mass of support has yet to be built. This assessment discusses five key aspects of governance that warrant renewed action over the next five years⁴: public financial management, public sector reform, public enterprise management and reform, intergovernmental relations, and corruption.

¹ Including minerals and hydrocarbons, export crops, domestic food crops, fisheries, village-based forest management, various types of small and informal business development, and tourism.

² In relation to ADB's development mandate, governance is defined as "*the manner in which power is exercised in the management of a country's economic and social resources for development.*" In broad terms, governance is about the institutional environment in which citizens interact among themselves and with government. It involves both public and private sectors. ADB has identified four basic elements of good governance: *accountability* for economic and financial performance, *participation* by all stakeholders, *predictability* of legal and regulatory frameworks, and *transparency* of decision making and information sharing.

³ The MTDS matches the Government's overarching policy framework, the *Program for Recovery and Development*, which was announced in 2002. It has three overarching objectives: good governance; export-driven economic growth; and rural development, poverty reduction and empowerment through human resource development. It targets seven expenditure priorities: infrastructure rehabilitation and maintenance; promotion of income earning opportunities; basic education; development-oriented, informal adult education; primary health care; HIV-AIDS prevention; and law and justice.

⁴ These are based on the range of analytical work undertaken in recent years including, for example, the joint situation analysis undertaken by ADB, AusAID and the World Bank in 2003; the European Union's baseline study of governance in PNG, completed in 2005; and Transparency International's 2003 report on corruption in PNG.

Public financial management

5. The extent and pace of PNG's recovery depends heavily on its ability to restore fiscal discipline and strengthen the integrity of budget institutions and systems, a process that will take many years and sustained commitment to effective governance. Both revenue and expenditure management are now set within medium-term frameworks⁵, the legislative frameworks for managing public finances are strong, and the process of reform to address compliance and other weaknesses is receiving active support, in particular through the *Public Expenditure Review and Rationalisation* (PERR)⁶ and *Financial Management Improvement Program* (FMIP). The priority issues are to stop unauthorized expenditures; rein in off-budget expenditures; and institute sound and transparent public procurement.

6. The PNG Government has made considerable progress since 2003. After several years of contraction, the economy has grown steadily for the past three years. Macroeconomic stability has improved, with a budget surplus achieved in 2004 and another expected in 2005. Although good commodity prices have been a key factor, windfalls have been managed prudently. The surplus has been used to retire debt and pay arrears, and the debt portfolio is now more balanced and lower risk. Inflation has declined, foreign reserves have increased and the kina has been stabilised. Approximately 400 trust accounts have been identified for closure, and financial controllers have been installed in most major spending departments. There is greater transparency and consultation with the private sector and civil society around the preparation of the budget, and the introduction of quarterly budget reviews should improve agency accountability for budget implementation.

7. A major structural impediment to efficient service delivery is the public sector wage bill, which consumes a large percentage of the government's available revenue. As part of the PERR process, the Government is working actively to reform the civil service payroll and size, monitoring public sector recruitment action to ensure it is consistent with staff structures and funding availability; issuing redundancies; and addressing the large pool of unattached officers. It has also established a *Rightsizing Committee*, the report of which is now with Government for consideration.

8. While it is important to recognise the responsible reforms and positive results to date, PNG officials themselves stress the fragility of the stabilisation they have so far achieved. The Government does not yet have adequate control of expenditure, establishment or payroll. Although core systems and processes are in place and appear to be sound, they are not always followed, and much more work is needed to ensure they are entrenched and well-respected before more complex reforms are attempted.

9. In this context, a recent PERR mission of development partners (led by World Bank, and involving ADB and Australia) recommended that the PNG Government re-focus the PERR implementation strategy on the highest priority reforms: secure control of expenditure,

⁵ *The Medium Term Fiscal Strategy* includes a four-point plan for fiscal sustainability: immediate cuts to discretionary expenditure; systematic reviews of expenditure programs; structural improvements in Government budget processes; and fostering an environment for private sector driven growth. The *Medium Term Debt Strategy* aims to reduce total public debt from 55% of GDP in 2004 to 45% of GDP in 2009; reduce the proportion of foreign currency debt from 59% to 40-45%; lengthen and smooth the maturity profile of domestic debt; and restructure the currency composition of external debt to match foreign exchange reserves and reduce foreign exchange risk.

⁶ The PERR analysis (2003) was led by the World Bank, with active participation by the PNG Government, ADB and AusAID. Annual (joint) follow-up missions have been conducted to monitor progress and define priority areas for future emphasis in the Government's reform efforts. The most recent PERR mission concluded in September 2005.

establishment and payroll; and deliver the budget as approved. In order to entrench and secure the gains made so far, the focus in 2006 must be on strengthening leadership, management, incentives for performance, the capacity of personnel and systems, and transparency and accountability mechanisms. The emphasis should be on making existing systems and processes work before changing structures. Underpinnings include respect for procedures, accurate record-keeping, information-sharing and ethical behaviour. Until stronger management and financial accountability systems are in place, structural reforms will be compromised, and the disruption involved may worsen performance.

Public sector management and reform

10. The capacity of government departments and particularly central agencies has been steadily eroded in PNG, in large measure due to the politicization of the bureaucracy. Institutional weaknesses undermine the links between policy, budgeting, and implementation, and public sector agencies continue to lack capacity to formulate and implement policies, plan operations, design and execute programs and projects effectively, and monitor feedback. In short, the PNG public service lacks the ability to anticipate, enhance and manage change.

11. Rebuilding an effective bureaucracy is an important priority for PNG, essential to improving the allocation of resources to priority areas and supporting improved performance of government in the use of resources for service delivery. This process is being driven primarily by the Government's *Strategic Plan for Supporting Public Sector Reform in PNG 2003-2007*, and will also be guided by the recently completed report of the *Rightsizing Committee*⁷. It is supported by the *Public Sector Management Reform Unit (PSRMU)*, a small, high level unit established in 2000 to drive and support the public sector reform process.

12. Over the long term, the aim is to create an honest and efficient career civil service, with a transparent pay structure, that is dedicated to the public interest. In the short term, the priority must be to provide incentives for managers and staff to deliver on work plans. Capacity building efforts need to be intensified for staff at all levels, and workplace systems and processes need to be streamlined, efficient and transparent.

13. Leadership, motivation and integrity are key to creating and sustaining capacity. As a first step toward ensuring more stable leadership across the public sector and improved accountability for the performance of public sector agencies, the Government has put in place a merit-based appointments system for departmental heads, provincial administrators and heads of statutory authorities. It has also endorsed a 10-15 year framework for public sector workforce development, with action plans addressing both the supply and demand issues affecting workforce development. A program of *functional expenditure reviews (FER)* has been completed in 17 agencies, providing a platform for internal organisational reforms aimed at reducing expenditure and improving services. The FER process is directly supported by a *Services Improvement Program (SIP)*, introduced in 2000 to provide national and provincial government agencies with the skills needed to evaluate their practices and procedures.⁸

14. Strengthening central agencies and improving institutional practices across the public sector are also critical priorities. Many of the FERs have identified weaknesses at this level as

⁷ The Rightsizing exercise has involved a systematic examination of the whole PNG public sector. It is intended to identify, for the medium-term, ways to eliminate inefficiencies in government structures, return public sector agencies to core government functions, and streamline the process of government administration.

⁸ Some eight national agencies and six provinces have benefited from the SIP to date.

having adverse impacts on both the pace and extent of reform implementation at a program level. The Australian Government's *Enhanced Cooperation Program* (ECP) is working to address the institutional weaknesses that are impeding both economic recovery and reform across government. Establishment of the *Central Agencies Coordinating Committee* (CACC) has also been a significant institutional reform, albeit with much work still needed to enable it to function as intended.

Public enterprise management and reform

15. This is a critical element of the broader governance agenda in PNG. There has been a proliferation of statutory authorities (SAs)⁹ in PNG in recent years, the expectation often being that these would bring efficiencies. SAs now control a substantial amount of PNG's public resources yet, in many cases, their performance is not meeting expectations. Further, the Government is concerned that the transfer of core government functions (including power over key national resources) to independent agencies has created major problems for public sector management. There are questions over the appropriateness of functions performed, value for money, and duplication of roles with government departments. The Government has increasingly less flexibility to allocate budget funds to national priorities and, in some cases, to direct SAs on their policies and operations. Some SA activities are grossly over-funded at the expense of key areas such as education, health, infrastructure, and law and order.

16. The roles, responsibilities and accountabilities of SAs are not always clear or well enforced. Oversight, policy guidance and coordination by government have declined and lack of budgetary control has seen unchecked expenditure growth. Accountability and disclosure arrangements are either ignored or inadequate, while financial management information is unavailable or incomplete. Lack of control over the administrative and operating costs of SAs has resulted in substantial amounts of public funds being inappropriately retained, invested or wasted by SAs.

17. An underlying problem appears to be lack of clarity on the appropriate role for the state and the lack of an unbiased examination of which goods and services are best provided by private or public institutions. Hopefully, the report of the Rightsizing Committee will provide guidance on this issue, along with recommendations on the areas where corporatisation or privatization are appropriate in PNG. Another core problem is that, having provided the existing SAs with independence and autonomy, it is very difficult to take back control.

18. The report of a recent review¹⁰ of the operations of SAs has confirmed the Government's concerns, finding that "many are non-transparent, subject to an ineffective accountability regime and poorly supervised" and that the hope for efficiency savings "has been a triumph of optimism over experience". The review has recommended a number of reforms, including introducing a far stricter regime for non-performing SAs. As a result of the review findings, the Government has committed in its 2006 budget to a range of measures designed to improve budgetary control and accountability of SAs, strengthen their governance and provide effective oversight of their operations and performance.¹¹ Government plans for privatization of any major enterprise are now on hold. Instead, the Government is working with management boards to obtain internal

⁹ For example, there are now over 200 non-commercial statutory authorities in PNG.

¹⁰ Dean (2005), a Government review undertaken as part of the PERR program, with World Bank assistance.

¹¹ These include amending the *Public Finances (Management) Act* and the constituting acts of SAs such that the expenditure of most SAs must be formally approved by Government; introducing a requirement for revenues and 'dividends' collected by most SAs to be paid directly to consolidated revenue; improving the reporting regime for SAs; and continuing to enforce the 2004 NEC decision placing a moratorium on the creation of further SAs.

operating efficiencies. This is starting to yield some governance improvements in key revenue agencies.

19. Assistance is likely to be needed to implement any significant reform of the governance of public enterprises. Although the technical changes may be straightforward, building the necessary political will is critically important. There would be value in providing support for advocacy and consultation to encourage key stakeholders to embrace the various public enterprise reforms.

Inter-governmental relations and responsibilities

20. Decentralized institutions play a crucial role in service delivery in PNG, and are an integral part of the structure of PNG governance. At the same time, inequity of funding across districts and provinces and continuing confusion over the functional and financial responsibilities of each level of government have contributed to deteriorating governance and progressive decline in service delivery.

21. Although the New Organic Law¹² established decentralized responsibilities and authority across three levels of government in a more equitable sharing arrangement, it did not adequately address implementation issues. Central, line, provincial and local-level government agencies were left to legislate their respective administrative functions and responsibilities with respect to other government agencies. Inadequate guidance and management of this process has resulted in incomplete and open-ended arrangements, with responsibilities poorly matched to authority. Lines of authority between the three tiers of government are largely absent, and it has become progressively easier for both politicians and public officials to become less transparent and to avoid responsibility for service delivery. In reality, decentralization has allowed accountability at all levels to decrease.

22. The MTDS describes the system of service delivery that has arisen following the 1995 decentralization reforms as “dysfunctional”. With 85 percent of the population living in rural areas (and mainly outside the formal economy), serious law and order problems and HIV/AIDS now an epidemic, poor service delivery cannot be allowed to continue. Effective service delivery is a core function of government, critical to the welfare of citizens. Without it, PNG is likely to confront increasing difficulty ensuring stability and social cohesion.

23. Based on an extensive two year process of studies and consultation, the National Economic and Fiscal Commission (NEFC) has recently completed a *Review of Intergovernmental Financing*, which proposes significant changes to both the process and principles of resource allocation to provinces by the national government. In particular, the NEFC is recommending that:

- Intergovernmental financial arrangements should be based on equalization of services in all parts of the country.
- Funding for service delivery in provinces should be matched as closely as possible to the actual cost of those services, which differ considerably from province to province.

¹² The *Organic Law on Provincial Government*, enacted soon after Independence, decentralized many functions to the provincial governments. The “New Organic Law” (*Organic Law on Provincial Governments and Local Level Governments*) enacted in 1995, decentralized further to the district level.

- All resources received by provinces and local-level governments (recurrent and development) should be taken into account in calculating the transfers they receive from the national government.
- The transfer pool of service delivery grants should be increased by including some or all of the provincial GST revenue, and mining and oil royalties.
- The size of the transfer pool should be kept affordable by making it a share of total National Government revenues after debt servicing and other essential commitments have been met, not a fixed kina per head amount.

24. The Government is currently considering the NEFC report. If endorsed, implementation of these reforms will require considerable political will and, in the first instance, support for advocacy efforts will be crucial. As the PERR has pointed out, any further structural or other changes in relation to decentralization must be considered and costed carefully, to ensure they are affordable, sustainable and will in fact lead to better service delivery.

25. At the same time, the PNG Government has just introduced a program establishing district treasuries. The aim of this *District Treasury Roll Out* is to provide government financial services to rural areas and complement the provision of basic services to rural areas under the related *District Services Improvement Project*.¹³

Corruption

26. Corruption is widely acknowledged as a serious issue in PNG, yet the lack of concerted actions against corruption is damaging the country's image.¹⁴ In the public sector particularly, corruption is endemic. Transparency International (2003) found that, with the exception of the judiciary and Ombudsman Commission, government institutions are "perhaps tolerant and passive towards corruption". As in many other resource-rich and capacity-poor economies, policy and institutional weaknesses have facilitated rent-seeking behaviour by public officials, led to pervasive corruption in public administration, and weakened confidence in government. Critical areas of concern continue to include budget management, forestry, fisheries and public procurement. As with most of PNG's governance challenges, the legal, structural and policy frameworks in place to prevent and address corruption are adequate. The weakness lies in implementation – including lack of political will and the limited capacity (financial and human) of relevant agencies to fight corruption.

27. Broad reforms that improve governance will contribute significantly both to reducing corruption and reducing tolerance of corruption in PNG. Key issues include depoliticizing public administration; strengthening the quality of leadership, financial management, and transparency; enforcing existing policies, legislation, regulations and other systems; and encouraging greater openness and participation in the operations of government. More specifically, continued support will be needed to strengthen accountability institutions and ensure the rule of law is enforced and therefore reliable.¹⁵ For example, the PERR has identified three key priorities:

¹³ A total of 24 District Treasuries has already been officially opened.

¹⁴ In the 2005 Transparency International Corruption Perceptions Index, for example, PNG ranks 130 out of 159 countries, where 1 is least corrupt and 159 is most corrupt.

¹⁵ The latest arrangements for Australia's *Enhanced Cooperation Program* in PNG specifically include an anti-corruption strategy.

- The Ombudsman Commission already plays a key role in enforcing the Leadership Code and investigating citizen complaints of administrative malpractice, but needs continuing support, in particular to deal with specialized areas of abuse.
- Prosecutorial, judicial and police functions need strengthening to make the rule of law credible.
- The Auditor-General's Office is attempting to catch up with the back-log of audits, but will need stronger skills and management in order to supply the effective and timely external audits that are critical for accountability.

28. Beyond these, Transparency International argues that establishing an *Independent Commission Against Corruption* (ICAC) should be given high priority. The primary mandate of the ICAC would be to deal with criminally corrupt practices of leaders, a role currently being performed by the Ombudsman Commission. This proposal has widespread support from non-government bodies, but the bill recommending its establishment has yet to be considered by parliament.

Concluding comments

Sustained success of reform efforts aimed at improving governance in PNG depends on **more rigorous priority setting**. Trying to undertake extensive reforms in the short-term is likely to be a recipe for disaster, achieving piecemeal results and potentially demotivating stakeholders. In the short-term, both Government and its donor partners need to maintain focus on a few key priorities for reform and, as far as possible, work on strengthening existing systems rather than introducing new ones.

Sustained success also depends heavily on **commitment by government to breaking some key bottlenecks**. Serious priority must be given to:

- Depoliticizing public administration;
- Actively supporting and strengthening leadership and management to promote ethical behaviour, accountability, transparency and a sense of national interest and to drive constructive change;
- Identifying and providing incentives to perform; and
- Developing a whole-of-government approach to policy formulation, resource allocation, and activity implementation – breaking down silos and fostering coordination, collaboration and integration of action agendas (across government as a whole, but especially across central agencies).

References

ADB (1999). *Governance: Sound Development Management*, Manila.

ADB, AusAID & World Bank (2005). *Aide Memoire: Public Expenditure Review and Rationalization*, August 22 – September 2, 2005.

ADB, AusAID & World Bank (2003). *Public Expenditure Review and Rationalization*, September.

ADB, AusAID & World Bank (2003). *Joint Situation Analysis*, Working draft prepared for discussions with the Government of Papua New Guinea on development of a joint country strategy, 2003-2006, August.

Dean, P.N. (2005) *Improving Fiscal and Governance Oversight of Non-commercial Statutory Authorities in PNG*, September.

European Union (2005) Baseline Study Report for the 9th EDF Governance Programme: The Governance Sector in Papua New Guinea, Draft Report, October.

Government of Papua New Guinea, ADB, AusAID & UNDP (2005). *Aide Memoire: Joint Review of the Papua New Guinea Financial Management Improvement Programme*, August.

Government of Papua New Guinea (2005) *Review of Intergovernmental Financing*, Consultation Paper, National Economic and Fiscal Commission, July.

Government of Papua New Guinea (2004) *Medium Term Development Strategy 2005 – 2010: Our Plan for Economic and Social Advancement*, November.

Government of Papua New Guinea (2002) *A Strategic Plan for Supporting Public Sector Reform in Papua New Guinea 2003 – 2007*.

Mellor, T. & Jabes, J. 2004. *Governance in the Pacific: Focus for Action 2005 – 2009*, Asian Development Bank, Manila.

Narayan, F. & Godden, B. (2000) *Financial Management and Governance Issues in Papua New Guinea: Diagnostic Study of Accounting and Auditing*, Asian Development Bank, Manila.

Transparency International (2003) *National Integrity Systems: Transparency International Country Study Report Papua New Guinea 2003*.

World Bank (2004) *Papua New Guinea: Poverty Assessment*, June.