SECTOR ASSESSMENT (SUMMARY): PUBLIC SECTOR MANAGEMENT

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. Strengthening public sector management (PSM) systems and practices in Papua New Guinea (PNG) will improve the government’s ability to effectively and efficiently utilize public finances for service delivery and infrastructure provision. Strengthened PSM is also needed to ensure that revenue from the recent commencement of liquefied natural gas exports and other mining and petroleum projects are efficiently and equitably utilized.

2. The most recent public expenditure and financial accountability assessment in 2009 confirmed progress in several areas.1 The debt burden is significantly lower and more balanced through the effective implementation of a debt strategy and the application of fiscal surpluses to reduce debt.2 Budget preparation is more orderly, transparent, and consultative as a result of the Fiscal Responsibility Act. Furthermore, the government has strengthened fiscal planning and expenditure management by adhering to principles laid out in medium-term fiscal strategies that were first implemented in 2003. The proposed integration of recurrent and development budgets for 2015 and continued efforts towards the implementation of multiyear budgeting should help further improve medium-term expenditure planning and prioritization. The establishment of a branch in the Department of Finance to monitor “off-budget” statutory bodies, with the assistance of the Asian Development Bank (ADB), is a positive step.

3. However, important weaknesses continue to impede the government’s ability to control expenditures, disburse the budget as approved, and provide an adequate PSM framework for the delivery of essential services. Often, fundamental arrangements are in place but implementation weaknesses mean that the systems and procedures for expenditure control cannot be relied upon to ensure appropriate accountability. Transparency in budget execution is weak, with budget integrity undermined by frequent diversion of funds.

4. PNG’s weak PSM adversely impacts the efficiency of state-owned enterprise (SOE) operations. ADB analysis3 has shown that as a result of these deficiencies SOEs continue to use capital wastefully,4 distort market conditions, discourage investment, and impose an implicit heavy tax on consumer welfare. The corporate governance environment under which SOEs operate is defective and contributes to poor commercial performance. Noncompliance with key elements of regulatory acts weakens governance and accountability. Moreover, the limited corporatization that has taken place has not prevented political interference in SOE operations.5

5. Similarly, deficiencies in regulatory and competition frameworks continue to hobble competition and the expansion of the private sector, particularly in important areas such as financial services and microfinance. In 2013, the fully government owned finance SOE, the

4 Between 2002 and 2012, PNG’s SOE portfolio generated an average return on equity of 5.8% and return on assets of 3.3%, well below the commercially established risk-adjusted return. Moreover, these low returns were achieved after subsidized debt and substantial fiscal transfers to the SOEs.
5 For a more detailed analysis of these SOE constraints see ADB. 2014. Public Sector Management Sub-Sector Assessment (SOE reform). Unpublished.
National Development Bank, was instructed to artificially reduce its lending rate to 6.5%, well below average market lending rates of 10.0%–12.0%. This direction, and the establishment of another government-owned microfinance institution (the People’s Microbank\(^6\) in 2013) could harm competition by undermining the sustainability of private banks and the expansion of services to the rural majority. Poor governance practices which leave a large amount of discretion in regulatory decision making and in tax administration further reduce competition and efficiency. Concern has been expressed by businesses that this type of activity, combined with uncertain or weak legislation, continues to have an adverse impact on competition in various areas of the economy, impeding businesses from entering and expanding in markets.

2. **Government’s Sector Strategy**

6. PSM is an important component of the government’s Development Strategic Plan, 2010–2030. The plan focuses on (i) improving and strengthening public sector reform efforts, (ii) improving budgeting and financial management for effective service delivery, and (iii) creating regulatory and accountability settings to enhance accountability and performance of public agencies.\(^7\) The plan acknowledges the weaknesses in PFM and has set ambitious targets for improvement based on the World Bank worldwide governance indicators and public expenditure and financial accountability indicators.

7. The government’s focus in PSM has historically been driven by joint government and development partner reform plans. The financial management improvement program supported by ADB, which first commenced in 1997, was an integrated program of reform of PFM systems and processes within and between national, provincial, and local governments in PNG. Subsequently, a detailed action plan for public expenditure reform was prepared under the 2003 public expenditure review and rationalization process. The completion of the 2003 process guided a significant scaling up of support for PFM by the Government of Australia with the establishment of the Enhanced Cooperation Program (ECP). With a large package of technical assistance, the ECP targeted a broad range of PFM issues included within the twin mandates of strengthened financial and economic management and promotion of public sector reform and governance, including a broad anticorruption focus. In 2009, the ECP was renamed as the Strongim Gavman Program, continuing the approach of Government of Australia agencies providing capacity development assistance and advice to counterpart Government of PNG agencies. As of 2014, the Strongim Gavman Program remains the largest source of foreign assistance to PNG’s PSM reform agenda, and is complemented by a number of other governance programs funded by the Government of Australia, including the Provincial and Local Level Governments Program and the Economic and Public Sector Reform Program.

8. In lieu of the large levels of support being provided by the Government of Australia, other development partner efforts since 2003 have predominately been targeted at more specific issues and reform objectives. The provincial capacity building program, which first commenced in 2005 as a subcomponent of the financial management improvement program, aimed to strengthen subnational financial management capacity and accountability in a sustainable manner. In 2009, ADB and the World Bank jointly supported government fiscal management and PFM reform efforts through the Framework for Fiscal Management Enhancement.\(^8\) The

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\(^6\) People’s Microbank is a wholly owned subsidiary of the National Development Bank. It competes directly with private banks and microbanks for market share.


framework had three priority areas: (i) managing financial volatility by maintaining long-term fiscal sustainability and safeguarding sudden gains in revenues; (ii) strengthening service delivery through budget expenditure prioritization and effective implementation; and (iii) reinforcing the integrity of budget systems and processes by delivering comprehensive, transparent, and accountable budgets.

9. More recent PSM reform efforts have met with some higher levels of success, in part because of their less ambitious objectives and higher levels of operational relevance to ADB. In 2012, the Department of Finance requested ADB support to assist in the initial establishment and operation of the new statutory authorities monitoring branch, and ADB was able to respond with technical assistance (TA). The branch is monitoring compliance of statutory authorities with the governance framework and, more generally, will monitor the performance of statutory authorities against their performance plans. This statutory authority support has also been closely aligned with ADB’s ongoing transport and energy sector operations.9

10. Policies to promote SOE regulatory reform and competition frameworks in the economy have also received a growing emphasis over recent years. This has included the formation of an independent competition and consumer commission (ICCC) in 2002, regulatory reforms in telecommunications and the entry of private companies in mobile telephony since 2007, and the planned role for public–private partnerships (PPPs). However, as stated previously, while the government has moved to promote competition in telecommunications, it has undertaken a number of policies that risk undermining competition in the banking industry, in particular through its expanding support for subsided government financial services.

3. ADB Sector Experience and Assistance Program

11. ADB’s last stand-alone lending operation in PSM was through the PNG Financial Management Project10 (approved in 1999). In late 2006, the processing of supplementary financing for the project revealed critical weaknesses. In response, ADB and the government identified remedial actions, but they were unable to confirm these actions and the processing of the supplementary financing was discontinued in early 2008.

12. Since then, ADB’s work in PSM in PNG has been delivered through a range of more targeted TA projects. In 2011, the TA for Supporting Public Financial Management11 supported the design and implementation of systems for financing the construction and maintenance of infrastructure from rising natural resources revenues, and has continued to assist in strengthening the accountability of statutory authorities to the national government. ADB’s work with PNG’s SOEs and competition policy expanded rapidly in 2011 when a new government adopted a policy of increased transparency and accountability. PNG participated in ADB’s Pacific SOE benchmarking survey, supported by the Pacific Private Sector Development Initiative (PSDI), and the accounts of the SOEs were published for the first time in 2012. Since 2011, the PSDI has been assisting the Independent Public Business Corporation, the state agency tasked with overseeing nearly all of the government’s SOE assets. This has included supporting reforms to its governance arrangements, strengthening monitoring practices, developing a community

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9 Including the Border Development Authority, the Civil Aviation Safety Authority, the National Maritime Safety Authority, and the National Roads Authority.
service obligation policy,\textsuperscript{12} and identifying opportunities to expand service delivery through PPPs.\textsuperscript{13} More recently, the PSDI has provided targeted technical assistance to the Independent Public Business Corporation in its review of PPP options for the operation of a new ADB-financed tidal basin at Lae Port. Since 2011, the ADB Microfinance Expansion Project\textsuperscript{14} has also assisted national government agencies such as the Bank of Papua New Guinea to provide more appropriate supervision of microfinance institutions and savings and loan societies.

13. ADB’s experience with PSM reform in PNG has shown the following:
   (i) Reforms must be driven by the government. Attempts to impose external solutions have been largely unsuccessful, whereas government-led reforms—even if they take longer—tend to be more successful and sustainable.
   (ii) Change is not easy and takes time, but can be achieved and made sustainable.
   (iii) Capacity must be built in parallel with other reforms and should be an ongoing process. Lack of skilled employees in the government continues to be a problem, which is exacerbated by high private sector demand for personnel with financial skills.
   (iv) In lieu of the limited resources available for PSM reform compared to other development partners, ADB PSM initiatives will have most impact and relevance when they are able to link with, and support, existing sector operations and when they are targeted towards a clearly identifiable service delivery outcome.

14. Building upon lessons from previous PSM reform efforts, ADB will focus its support in PSM on specific interventions linked to ADB’s existing portfolio of projects that address critical public sector constraints on service delivery. ADB PSM assistance will also be more strongly linked to areas where a clear demand for assistance can be established. With regard to public financial management, this will include a priority on assistance that supports the more effective and sustainable creation of national infrastructure assets, including support for infrastructure planning and budgeting practices. To support the establishment of more transparent and predictable public finances, ADB will also remain ready to support the government in its efforts to implement a sovereign wealth fund and extractive industries transparency initiative. ADB will ensure these efforts are aligned with other development partners, particularly the long-term advisory positions funded by Australia across the PNG public service.

15. ADB will continue to work with government agencies to reform the legal and regulatory environment for the financial services sector. These efforts will support access to finance initiatives and build upon previous private sector support provided by ADB to Nationwide Microbank. Further, while some progress has been made on SOE reform, more needs to be done, in particular support for the implementation of the government’s community service obligation policy.\textsuperscript{15}

\textsuperscript{12} Protracted delays in reviewing the draft PPP law within the government in 2010–2013 created delays in the implementation of the TA, which has now been extended until December 2015.
\textsuperscript{13} ADB. 2010. \textit{Technical Assistance to Papua New Guinea for Facilitating Public Private Partnerships}. Manila (TA 7782–PNG for $800,000, approved 2009, financed by the Japan Special Fund).
\textsuperscript{14} ADB. 2010. \textit{Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Grant to Papua New Guinea for the Microfinance Expansion Project}. Manila (Loan 2686-PNG).
\textsuperscript{15} This is particularly important for those SOEs that will see considerable increases in demand as a result of increasing economic growth, such as PNG Power, National Airports Corporation, PNG Ports Corporation, Telikom PNG, Water PNG, and Air Niugini.
Problem Tree for Public Sector Management

1. Ineffective and inefficient utilization of public finances
   1. Development Impacts

   2. Difficulty in tracking expenditures to ensure budget is delivered as approved
      2. Challenges

   3. Lack of transparency in budget execution
   3. Weak internal control and accountability frameworks
      3. Delays in releasing public accounts
      3. Delays in releasing audit reports
      3. Poor oversight of statutory authorities
      3. Weak internal control and accountability frameworks
      3. Systems do not operate as designed or are overridden
      3. Lack of available guidance and training

      3. Unauthorized diversion of funds
      3. Poor compliance with medium-term frameworks
      3. Lack of monitoring of service delivery
      3. Capacity and resource constraints of entities
      3. Capacity and resource constraints of oversight agencies
      3. Poor state-owned enterprise financial performance and weak service delivery

      3. Strong demand from private sector for skilled finance personnel

3. Root causes

## Sector Results Framework (Public Sector Management, 2016–2020)

<table>
<thead>
<tr>
<th>Country Sector Outcomes</th>
<th>Country Sector Outputs</th>
<th>ADB Sector Operations</th>
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<tbody>
<tr>
<td><strong>Outcomes with ADB Contribution</strong></td>
<td><strong>Indicators with Targets and Baselines</strong></td>
<td><strong>Outputs with ADB Contribution</strong></td>
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<tr>
<td>High quality public sector management at all levels of government contributing to improved service delivery and promoting private sector development</td>
<td>ADB country performance assessment indicators 8a: equity of public resource use increased to 5.0 by 2020 (2014 baseline: 4.0)(^a) Increase in the Transparency International Corruption Perception Index from 3.0 in 2014 to 5.0 by 2020</td>
<td>More effective and efficient utilization of public finances for service delivery and infrastructure provision Improved enabling environment for business and finance sector development</td>
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\(^a\) CPA criterion are rated from 1 (low) to 6 (high).
\(^b\) PEFA indicators are rated from D (low) to A (high).