

Fiscal relations and service delivery

Chad Leechor

Although Papua New Guinea made significant advances in the provision of public services in the period directly following independence, since 1980 these have deteriorated. It is argued here that the distribution of both funds and responsibility between central government and local levels needs restructuring to ensure efficient and effective service provision.

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In the 1970s, a period of self-government and early post-independence, Papua New Guinea could take pride in its effective system of public services. Significant gains were made in the provision of primary health care and educational services. Roads were built, often in small networks that were separated by mountains and the sea. Literacy rates were on the rise, while infant mortality declined (World Bank 1994b: Chs 4–5).

But the gains in service provision were not sustained or carried further. In the past 15 years, the country has experienced substantial erosion of services in some areas and sharp deterioration in others. Among the visible signs are poor road conditions, reflecting inadequate maintenance, even in commercial centres like Lae. Violent crimes are on the rise. The recent spread of epidemics prompted the Ministry of Health to call a conference on the national health crisis in January 1995. Particularly hard hit are rural residents

with no convenient access to the provincial or national capital.

Among the major reasons for the decline of service delivery are fiscal arrangements and financial management at the centre. Provincial authorities, whether elected by the local voters or appointed by the centre, have become more publicly critical of the national government. Many have openly discussed the option of secession and forming a separate union independent of what is now Papua New Guinea.

The primary source of provincial concern is the system of revenue sharing. Most provincial authorities feel that the resources made available to them through established channels are inadequate to carry out the designated responsibilities (see Axline 1986). Furthermore, many provinces have complained that the allocation of revenue across provinces under the current system is inequitable:

population, revenue capacity, land area and topological features have not been taken into account. As a result, more populous and geographically larger provinces tend to get insufficient transfers.

Dissatisfaction with the fiscal arrangements led to the formation in 1992 of a bi-partisan parliamentary committee to review the Organic Law, which has the status of a constitutional provision governing fiscal relations. The committee presented its controversial findings and recommendations to the national government in March 1992 and the findings were presented to parliament in March 1993. Further reviews have been undertaken by the Wingti and Chan administrations. Legislation was presented to the full parliament in 1995. The final reading of the bill was presented and passed in the June 1995 sitting. Among the major issues being debated are

- the share of revenue being controlled and directed by the centre
- the role and effectiveness of provincial governments in representing the diverse groups within their respective provincial boundaries
- the role of national departments in supporting and advancing essential services, such as primary health care and

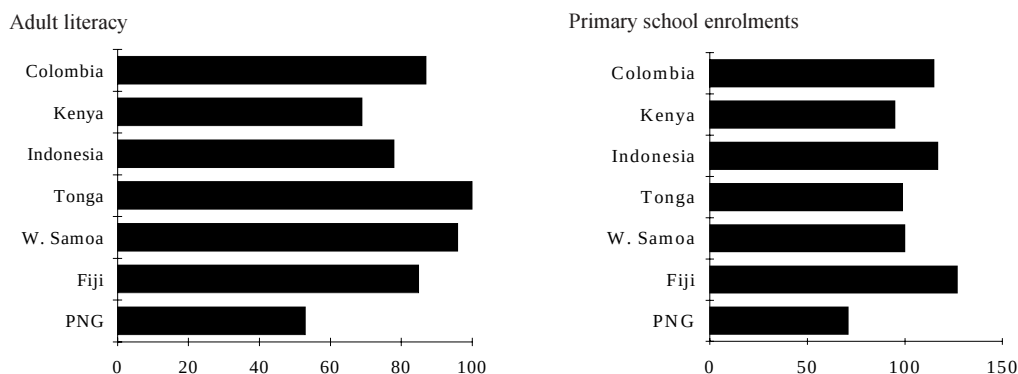
primary education, as provided by the provinces.

Often the debate is framed in terms of whether decentralisation has gone too far, undermining the quality of service delivery. The national government—often called ‘Waigani’ for the neighborhood in Port Moresby where it is located—generally favours more centralisation, based on the view that the lower tier of government has proved incompetent and irresponsible (see AIDAB 1994: 151–62). The recommendations of the bi-partisan committee, however, pointed in the opposite direction, calling for the establishment of district-level governments and more funding for their responsibilities. Under the recommended system, provincial governments are being retained but without provincial members. Instead national MPs along with district-level representatives will constitute the new provincial government, where the regional MP will automatically become the governor.

Record of service delivery

To understand service delivery in Papua New Guinea, it helps to keep in mind a few distinctive features of the country. The

Figure 1 **Adult literacy and primary school enrolment rates, selected countries, 1994** (per cent)



Source: World Bank, 1994. *Social Indicators of Development*, Johns Hopkins University Press, Washington, DC.

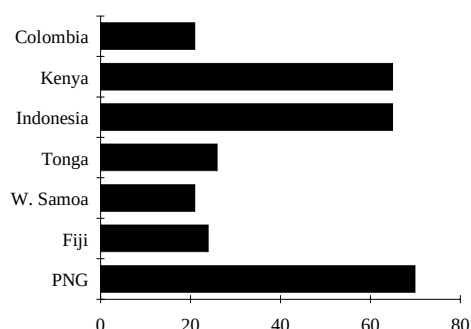
difficulties faced by service providers have much to do with these characteristics. First, the country's physical terrain presents an unusual challenge, with abrupt changes from tropical flood plains to highlands and mountains, in addition to many volcanic islands. Second, there is vast cultural diversity with more than 700 languages spoken among only 4 million people. They all have different values and aspirations but live together under the same rule of law and a common democratic tradition. Third, more than a third of the people had lived in isolation with virtually no contact with the outside world until about 60 years ago.

In addition, the country is richly endowed with natural resources. The exploitation of these resources has created an enclave modern sector, which has considerable wealth and amenities. The vast majority of the population, however, still rely primarily on agriculture, with standards of living like those of the poorest nations. As a result, the country is made up

of dissimilar communities and small internal markets divided by cultures, incomes and the natural landscape.

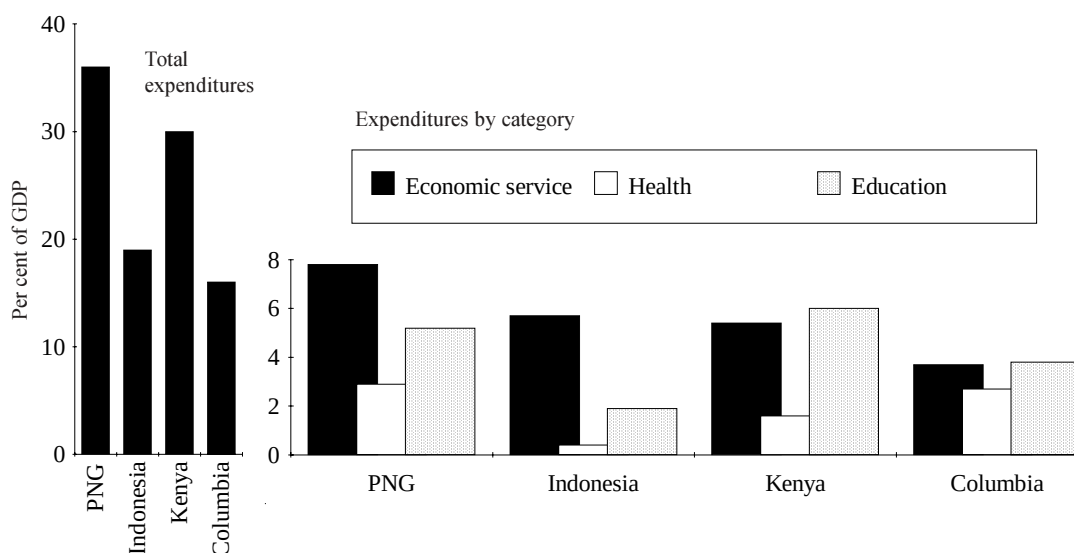
Because of resource-based export earnings, Papua New Guinea's per capita income, at about US\$950 in 1993, is

Figure 2 **Infant mortality rate, selected countries, 1992** (per 1,000 live births)



Source: World Bank, 1994. *Social Indicators of Development*, Johns Hopkins University Press, Washington, DC.

Figure 3 **Public expenditures, selected countries, 1992** (per cent of GDP)



Sources: World Bank, 1994. *World Development Report 1994: infrastructure for development*, Oxford University Press, Washington, DC; International Monetary Fund, *International Financial Statistics*, Publications Services, Washington, DC, various issues.

relatively high, higher than that of Indonesia and comparable to those of Peru and Cameroon (World Bank 1994b: 151–228). But a broad range of social indicators suggest that Papua New Guinea is lagging behind other countries in the same income group and in the same region (Figures 1 and 2). Only about one-half of Papua New Guinea's adult population is able to read, and the coverage of health and education services is also relatively low, comparable to low-income sub-Saharan African countries.

Being behind one's peer group is not necessarily an issue of concern, particularly when the country is confronted with a variety of special circumstances. What is of concern, however, is that the gap in social development is probably widening, with many essential public services showing signs of deterioration. Among the indications are

- health care is poor and declining
- too few children go to school and yet the dropout rate is very high
- infrastructure expenditures on maintenance have been inadequate and falling
- violent crimes reported to the police increased by more than 100 per cent between 1980 and 1990 (World Bank 1995).

The level and quality of service delivery is constrained by many factors, some of which are discussed further below, but money is not one of them. Papua New Guinea collects in revenue and spends a larger share of GDP than most developing countries. In recent years spending has outpaced revenue collection, creating large fiscal deficits, which at times have led to unplanned and disruptive spending cuts. At the sectoral level, Papua New Guinea's expenditures are also relatively high, both in terms of per capita spending and as a share of GDP (Figure 3).

Papua New Guinea's relatively high level of spending does not generally

translate into a high level of services. One reason is the high cost of getting things done in Papua New Guinea, reflecting in part the policy of maintaining a strong domestic currency, which was not changed until the second half of 1994. Wages, real estate rents and utility rates are higher in Papua New Guinea than in most developing countries.

In addition to the high wages and general overheads, sectoral policies and organisational management also contribute to the cost of service delivery. Overstaffing is common, as is the proliferation of new agencies. Within an agency, responsibilities are often fragmented and the lines of authority are blurred. Most public services are provided free of charge or at nominal fees. As a result, unit costs of most services in Papua New Guinea are relatively high.

While money is not an issue at the national or sector level, it is nonetheless often a constraint for many service agencies, particularly at the provincial level. Money does not get down to the front-line service level for various reasons, including the increasing share of debt service in the budget, the allocation between the centre and provinces and the public service personnel policies.

The equity dimension of fiscal relations

Provincial contributions to internally generated revenue vary significantly across provinces, ranging from more than one-half of the provincial budgets in Morobe to about 5 per cent in most of the non-autonomous provinces. The major sources of provincial revenue are profits from provincial business firms and the provincial sales tax, which is typically set at 2.5 per cent of sales. In addition, provinces collect motor vehicle registration fees, tobacco taxes and fees from leases of properties. Some provinces also get a significant part of their revenue from

mineral or oil royalties and derivation grants based on export tax collected by the national government.

The share of the provinces in centrally collected revenue is not constitutionally mandated or set as a policy variable, as is the case in many federations. Instead, the aggregate of provincial resources is the sum total of individual provincial transfers. What each province receives is driven mainly by historical benchmarks determined by the actual provincial spending level at the time the system was adopted. In addition to the established transfers, provincial governments also receive funding from the centre through the public investment program, but in practice this has not been a significant source of finance.

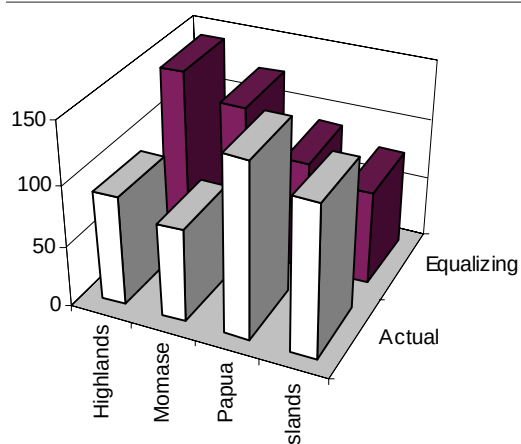
The size of the transfer under current arrangements does not depend on assessments of needs or performance. The only sanction used has been directed against misuse of funds, for which a provincial government could be suspended. Negligence of duty or non-

performance has not given rise to suspension or reduction in transfers.

There is thus considerable scope for rationalising provincial transfers. On the basis of equity considerations, a system of equal transfers per capita to every province would have the appeal of fairness and simplicity. As is the case in most federations, the principle of equalisation should be built into the transfers, with a relatively poor province getting a little more in per capita transfer, and a relatively well-off province getting a little less (see Broadway 1980 for a case study of Canada).

A system of equalising transfers would give rise to substantially different provincial allocations (Figure 4). At present, well-off provinces tend to get too much, as is the case with the island provinces. Relatively poor provinces tend to get too little, with the possible exceptions of Gulf and Milne Bay. The same pattern of transfers holds true at the regional level. The geographic regions with relatively low (per capita) income and high population density tend to get less in transfers per capita than the regions with high income. The transfers for the Highlands and Momase (Morobe, Madang and Sepik) regions are relatively small compared to the Papuan region and the islands, which have higher per capita income (Figure 4). The equalisation feature was also missing in the early years of the fiscal arrangement.

Figure 4 **Transfers and equalisation, actual 1993 vs hypothetical, by region** (kina per person)



Source: Papua New Guinea, 1993. *Estimates of Revenue and Expenditure*, Department of Finance and Planning, Waigani.

Efficiency dimension

Efficient provision of services involves enlarging service coverage for a given amount of resources or delivering a particular service at the lowest feasible cost. A more stringent interpretation of efficiency would also require that the services provided are indeed of value to the intended beneficiaries. Efficiency in the sense of getting the right kind of service

requires close involvement of the community, both in the assessment of needs and in the allocation of resources (Tiebout 1956). Efficiency in the sense of getting more output per unit of cost requires managerial discretion or autonomy to adapt to local conditions in choosing the input mix under local relative prices.

Community participation in local service provision has fallen significantly in the past two decades. In the 1960s and 1970s, local councils and area boards played a major role in planning, staffing and implementation of services (Conyers 1976). Local activities were financed by transfers from the national government to the local councils in the form of salaries and funds for capital works. In addition, villagers paid a head tax and helped defray the cost of service delivery by contributing food and labour. Today the funding for local participation has virtually dried up: head taxes are mostly not being collected. Transfers from the centre to the provinces have declined (Figure 5). The resources at the disposal of local and community-based groups have diminished to the point where many have ceased to function.

Of the 400 kina per person that the national government spent annually in the early 1990s, about 80 kina represented transfers (conditional and unconditional) to provincial governments. Most of the provincial resources, in turn, were controlled at the provincial headquarters. Local councils, to the extent that they were still functioning, received about one kina per person to spend at their discretion. The Village Services Program, implemented in 1994, brought back the direct transfers from the centre to the local councils. The transfers under the Village Services Program were set at about 6 kina per person but appeared to have been reduced sharply in 1995.

With the decline in the activity and involvement of local communities, the type of services desired by the people may not

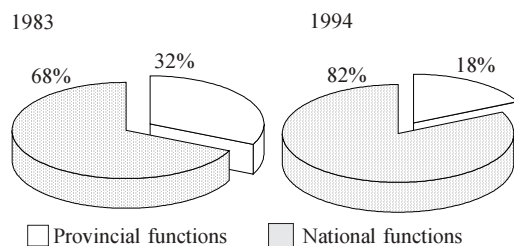
be adequately reflected in programs and projects formulated by the provincial and national authorities. To ensure responsiveness to local preferences, more funding, as well as technical support, for community groups is needed.

As with community involvement, granting more managerial autonomy to service providers can cut costs or expand coverage. The key issue here has to do with the established budgetary process and public service rules, particularly personnel policy set by the centre. Under the current system, provincial departments and the national public service are subject to the same employment and compensation rules. As a result, service providers at the provincial level have no collective bargaining powers and little control over staffing and budgeting.

In the context of declining resources, the high wages and the difficulty in firing staff have left service agencies throughout the country with insufficient funds. Among the provinces for which an expenditure analysis has been undertaken, it is found that for many essential functions, after paying salaries and wages, a small fraction of the budget is left to pay for operational expenses (Figure 6).

In addition, many mandates from the centre undermine managerial discretion and encumber services. Health

Figure 5 **Financial transfers to the provinces, 1983 and 1994** (per cent)



Source: World Bank, 1995. *Delivering Public Services*, East Asia and Pacific Region, World Bank, Washington, DC.

professionals, for example, are not allowed to provide private services after office hours. Teachers' pre-service training requirement has been raised unnecessarily. Service fees are also set by the centre with the rates applied uniformly across the country. At times of financial stringency, even appropriated funds are put on hold to be released on a case-by-case basis, further disrupting service delivery.

Recent trends in public sector management across countries have pointed in a different direction. In the United States, for instance, the federal government has allowed for pay differentials in different localities. New Zealand and Singapore have gone further. Under new public sector regulations, each agency acts as the ultimate employer of staff with the power to negotiate wages and service conditions (see Scott and Gorringer 1989 for discussion of New Zealand).

Papua New Guinea could also contain the cost of service delivery by removing duplication. In many services, national and provincial responsibilities overlap—there are both national and provincial high schools, and in each province two to three agencies are responsible for road administration (World Bank 1995: Ch. 7). Redundancy results in high costs. Furthermore, construction projects are broken up into small and uneconomic

parcels. This duplication of effort shows a lack of coordination across governmental tiers. The national agencies, where expertise and decisionmaking power is concentrated, have not taken the initiative and the guidance needed to improve efficiency, nor has the taxpaying public vigorously objected. Many national officials, as well as casual observers, however, have taken the view that the redundancy is an unavoidable result of decentralisation—to them the solution is more centralisation.

More or less devolution?

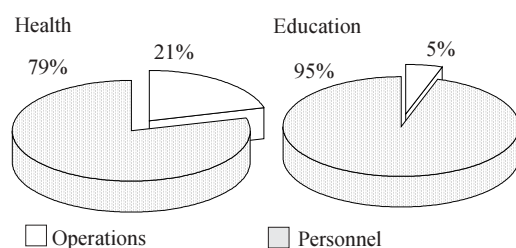
There is broad agreement in Papua New Guinea that service delivery needs to be improved, but how to achieve this remains controversial. The constitutional review committee of the national parliament is fashioning a solution that calls for significantly more devolution of service responsibilities. District-level authorities, 86 in number, would be created to provide the services now under the jurisdiction of 19 provinces. More managerial autonomy would be granted, as the transfers would be in the form of block grants rather than conditional grants. The size of the transfers would be determined by a formula containing population, local revenue and physical terrain.

There is considerable resistance to this idea on the part of both national officials and foreign advisors. Among the reasons given for their concern are

- local institutions and staff are not ready to take on the responsibilities
- the risk of mismanagement and irresponsibility would increase
- there would be more bureaucracy and overhead costs
- the country cannot afford the new expenses.

The solution, according to this group of people, is to recentralise service respon-

Figure 6 **Personnel percentage share of provincial budget for health and education** (per cent)



Source: World Bank, 1995. *Delivering Public Services*, East Asia and Pacific Region, World Bank, Washington, DC.

sibilities, turning the country from a semi-federation to a full-fledged unitary country. Each of the two opposing points of view seems to have a strong constituency. Those opposing more devolution were able to hold back a similar draft law proposed by a bi-partisan parliamentary committee in March 1993; however, the pro-devolution forces were able to revive the legislative proposal and bring it to the forefront in 1995.

There is more at stake than who wins the debate. Improving service delivery, particularly the essential services now provided by provincial authorities, is a national priority that should transcend politics. Upgrading human resources is an urgent matter. There is a risk that the lack of consensus will prevent serious reform despite agreement that the *status quo* is unsatisfactory. There is, however, some common ground. First, it is clear that national agencies, with more competent staff and more resources, need to play a more active role in ensuring more effective delivery of essential services which are now under provincial jurisdiction. Restoring technical support to and supervision of provincial services is much needed.

Second, there is broad professional agreement that managers of service agencies need more authority to manage and deliver results. Public-sector restructuring or re-engineering is being undertaken in many countries to achieve this goal. Public agencies are now expected to emulate the management practices of private companies.

In Papua New Guinea, service delivery could be improved in a major way under the current fiscal arrangements provided that

- service managers are given more autonomy, particularly in the area of staffing, wage-setting and local collective bargaining

- the centre takes its backstopping role more seriously, providing technical assistance to and supervision of services, whoever the providers may be

- the system of transfers is made more equitable.

The above conditions are also a necessary basis for recentralisation, but in this case needs assessments and delivery mechanisms must be developed from community-based organisations—perhaps guided by local non-governmental advisory boards. Funding for these services would need to be set on the basis of population and local costs.

Devolution of more authority and resources away from the centre, as envisaged by the new legislation recently passed in parliament, is a natural progression towards more effective services. Devolution alone is unlikely to improve services without a helping hand from the centre and without more operational freedom for managers.

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