

# Putting the Enhanced Cooperation Package to the test

Craig Sugden

The Australian Government's A\$1 billion Enhanced Cooperation Package (ECP) for Papua New Guinea has quickly emerged as one of Australia's most important aid policy initiatives for some years. The ECP is a high unit cost package, with the proposed placement of 300 Australian public servants and associated activities costing as much in a year as providing a year's education to more than 700,000 Papua New Guinea children. It is reasonable that the ECP, as for any expenditure initiative, should be expected to satisfy a cost-benefit test or at least a cost-effectiveness test. But there is considerable uncertainty as to whether the ECP offers a sustainable solution to Papua New Guinea's underlying problems. It may instead be limited to offering temporary relief to their symptoms.

The high opportunity cost of the package, the decision to provide support without conditionality and the absence of vigorous competition in the supply of services also cast doubt on the ability of the ECP to meet these economic tests. It is important that steps be taken to fill gaps in the accountability and transparency framework arising from the absence of standard project documentation and an independent monitoring regime. The priority for action is the police component which is to absorb 80 per cent of funds.

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One of the key issues to emerge in the Pacific region during 2003 was the shift in Australia's foreign policy to a more interventionist stance. First signalled in a paper by the Australian Strategic Policy Institute, the shift saw Australia send troops to the Solomon Islands accompanied by Australians to occupy line positions within the government. As Australia's main aid

recipient and a country widely seen as at-risk, it was inevitable that Papua New Guinea would come under consideration in Australia's new approach to foreign policy and aid delivery.

In August 2003, Australia signalled a toughening of its stance on the use of its aid to Papua New Guinea. This was highlighted by the Australian Prime Minister indicating



that aid would be linked to action against corruption—a position that was subsequently softened. A framework agreement was settled at ministerial level in September and the Enhanced Cooperation Package (ECP) was endorsed at a Ministerial Forum in Adelaide in December. The ECP was to be implemented in the early months of 2004, but it now appears that implementation of much of the package will be delayed until at least the middle of 2004.

Although considerable discussion is still to take place to clarify Australia's intentions and what Papua New Guinea will accept, Australia has committed to increase aid to Papua Guinea by 50 per cent, with the additional funds to be spent on governance.

The package is noteworthy for the substantial increase in aid provided, the higher priority attached to governance, and the placement of Australian public servants without recourse to the market or normal design process. The ECP warrants review as a stand-alone package and also with respect to what it may lead to in future interventions in Papua New Guinea and the region.

### The economic setting

The ECP is to be introduced into a firming macroeconomy, but one still in need of important structural reform (see Chand in this volume).

The fiscal responsibility of the government remains central to economic prospects, given the history of fiscal excess triggering macroeconomic instability. 2003 was the first full budget year of the Somare Government, and the budget figures provide an important insight into its fiscal credentials. The key fiscal target for the year was a deficit of K244 million, the equivalent of 2.0 per cent of GDP. As of March 2004 the deficit for 2003 was estimated as 1.3 to 2.0 per cent of GDP, so the government appears to have passed the test of aggregate expenditure control.<sup>1</sup> The

government also appears to have succeeded in limiting the public wage and salary bill to the target level. As of November 2003, the wage bill for National and Provincial Departments was estimated to be only K18 million more than the budgeted level.<sup>2</sup> This compares to an over-run for 2002 (calculated on comparable terms) of K115 million. The November estimates of the wage bill have been close to the final estimates in recent years and this gives some confidence that the wage and salary over-run for 2003 was small.

The small over-run on the wage and salary bill is important for two reasons. First, the small increase in the wage and salary bill budgeted for 2003 seemed to be one of the weak points of the 2003 Budget. If it was indeed achieved, it suggests that there is commitment to expenditure restraint and the new controls introduced over the year have worked. Second, correcting the high wage and salary bill is probably a pre-requisite to re-balancing government expenditure and raising the effectiveness and efficiency of the national and provincial governments.

These two broad indicators paint a picture of a government working towards its targets. Not all indicators show as favourable a picture but if the budget outcome is as good as appears, the government deserves credit for beginning to correct an extended period of poor fiscal management.

One of the key risks to be faced in 2004 is the consequences of the threat of a vote of no-confidence against the Somare Government. At the time of its introduction by the Morauta Government, the new Organic Law on the Integrity of Political Parties was widely expected to put an end to the votes of no-confidence that have been faced by every popularly elected government since independence. The law prevents individual party members acting against their party's position with respect to the prime minister, but does not prevent whole parties shifting



allegiance. The threat of a vote of no-confidence remaining in this legislation was behind the Somare Government's decision to adjourn parliament until the middle of 2004. The actions taken up to that time to develop support for the government, and events after the vote, may have an important bearing on the economy over the medium term.

Perhaps one of the key economic management issues to be faced over the medium term is the composition of government expenditure. In nominal terms government expenditure and net lending has grown steadily over time. This has been made possible by additional borrowings required to offset a levelling-off in internal revenue, and the fall in the kina has also increased the kina value of donor-funded expenditure (all in nominal terms). Changes in the purchasing power of this expenditure are difficult to assess because of uncertainty in the relevant price index, but it appears that in real terms expenditure has trended down since 2000 (Figure 1).

In real terms the wage and salary bill has been steady over time (Figure 1). The steady wage bill at a time of falling real expenditure has created pressure on other expenditure items, notably the funds available to national departments and provincial administration for goods and services. Real expenditure on goods and services was reduced substantially over 2002 and the high domestic interest bill prevented correction of this over 2003. It will be difficult to correct the pressure on funding for goods and services quickly, and this will result in continued problems for the delivery of basic services.

This is well illustrated by the latest official forecasts. They factor in undefined expenditure cuts from 2005 in the order of 2 per cent of GDP, to compensate for a forecast decline in the real value of internal revenue (the cuts are factored into the 'Other' expenditure category of Figure 1 and account for much of the fall shown). Based on past

performance, any such cuts are most likely to fall on goods and services eventually.

Despite the problems in the economy, statistics from the 2000 Census (released in 2003) confirm that the substantial long-term improvements in key health and education indicators have been preserved (Table 1). But an issue of concern is the apparent stalling during the 1990s in the improvement in health standards. While life expectancy at birth and the child mortality rate improved over the first half of the 1990s, both indicators have since levelled off. Infant mortality rates have shown relatively little change since 1980.<sup>3</sup> A widely held concern is that health indicators will deteriorate from 2000 as the full effects are felt of declining service standards in the health and road sectors. The key indicators show improvement over the 1990s in the education sector as the new education policy broadened school participation, but there are some concerns that the funding and service quality are insufficient to provide sustainable gains.

### The ECP in brief

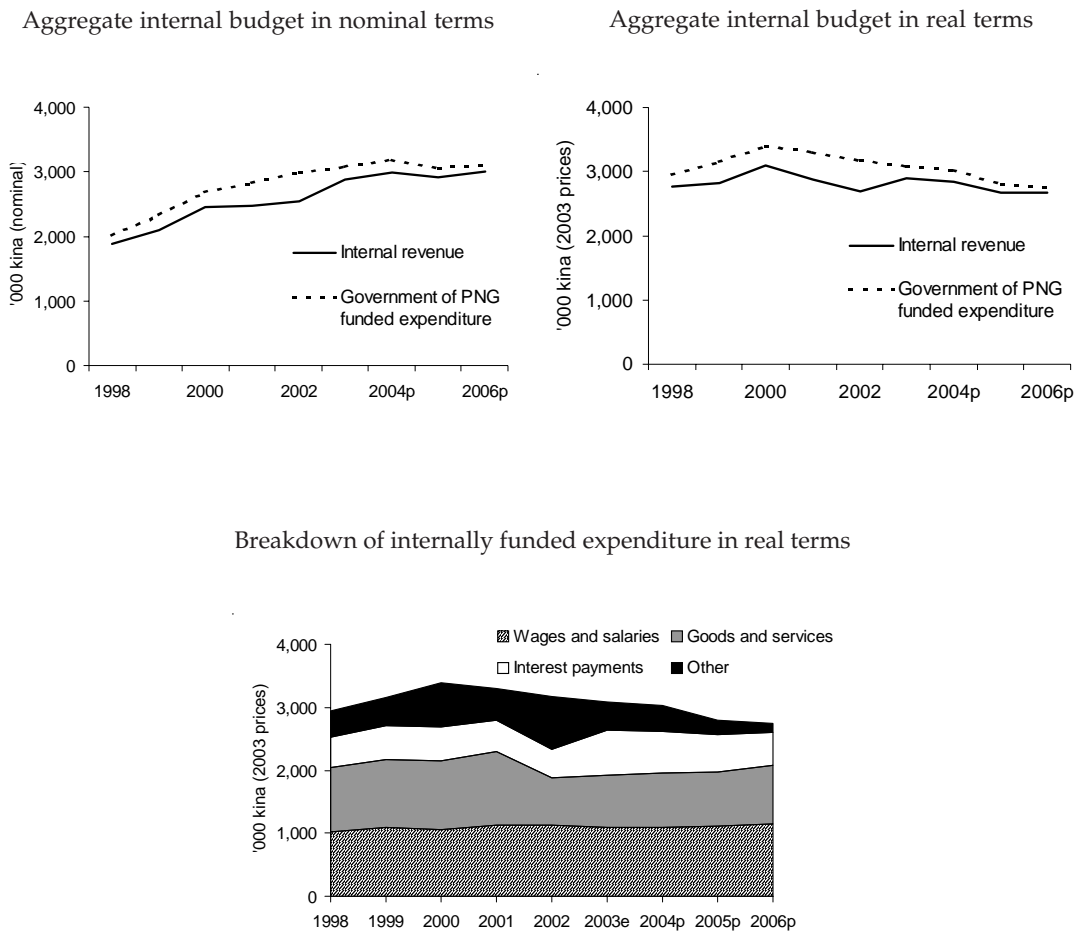
The ECP centres on the placement of up to 300 Australian officials in advisory and line positions.<sup>4</sup> The proposed placements include

- police in the main centres of Port Moresby, Lae and Mt Hagen, on the Highlands Highway, and in Bougainville.
- 18 specialists in the non-policing law and justice agencies (including four judges).
- up to 36 officials in key economic, finance and planning agencies.
- 12 officers focused on border control (immigration and customs and transport agencies).

The ECP also provides for equipment, goods and services such as fuel and the training and placement in Australian Government agencies of Papua New Guinea staff.



Figure 1 Papua New Guinea 'internal' budget, 1998–2006 ('000 kina)



**Note:** 'Wages and salaries' and 'Goods and services' include expenditure by national departments and provincial administrations. 'Other' mainly comprises locally funded development expenditure, other grants and transfers (that is, for items other than those separately specified in the figure) and undefined savings in expenditure.

**Source:** Author's estimates from Papua New Guinea (various years), *Budget Papers*, Volume 1: Economic and Development Policies; Volume 2: Part 1, Recurrent Budget Estimates of Revenue and Recurrent Expenditure of National Departments; and Volume 2: Part 3, Estimates of Development Expenditure of National Departments, Statutory Authorities and Provincial Governments, deflated by a government expenditure deflator based on across-the-board wage increases in the public services and the CPI (to reflect the price of goods and services).



Table 1 Papua New Guinea's key development indicators, 1971–2000

	1971	1980	1990	1996	2000
Infant mortality rate (per '000)	134	72	82	73	64
Child mortality rate (per '000)	91	45	56	24	25
Average life expectancy at birth (years)	40	50	52	54	54
Average life expectancy at age 25 (years)	32	35	38	..	38
Literacy (per cent of population aged 10 years and over)	..	..	45	..	56
Attending school (per cent of population aged 5–29 years)	..	21 <sup>a</sup>	20	..	26

<sup>a</sup> Per cent of population aged 5–25 years.

**Note:** All statistics are derived from the National Census, with the exception of the statistics for 1996 which are from the Demographic Health Survey. As these statistics are derived from the primary data source, they should be used in preference to those statistics reported in the World Bank's *World Development Indicators* and other secondary sources.

**Source:** National Statistical Office, 2003a. *2000 National Census: National Report*, National Statistical Office, Port Moresby; National Statistical Office, 2003b. *Recent Fertility and Mortality Indices and Trends in Papua New Guinea: a report based on the analysis of the 2000 census data*, National Statistical Office, Port Moresby.

The support for the Royal Papua New Guinea Constabulary (RPNGC) is costed at A\$805 million and the remaining components are expected to cost in the order of A\$200 million. This gives a total cost of approximately A\$1 billion. With a timeframe for implementation of five years, the annual cost is on average A\$200 million. The A\$800 million for the police is new funding, while the remainder of the package is to be funded from the existing aid budget for Papua New Guinea. This new commitment will lift the share of Australia's aid program focused on governance from approximately 30 to 55 per cent.

Although the full five-year program of the ECP has not been made public, it is understood that at least the economic governance component is expected to evolve from its initial form. In particular, there is an appreciation that the initial placements of officers in line positions in central agencies will fail to generate sustainable benefits with respect to capacity building, and that over time more attention will need to be paid to building capacity. The means of making this transition to a focus on capacity building is still being developed.

The ECP was to be implemented in the early months of 2004. But the placement of many Australian staff is conditional on certain immunities being provided, and this requires new legislation in Papua New Guinea. The threat of a vote of no-confidence and planned adjournment of parliament to mid-year is expected to see a delay in the implementation of much of the package until at least then if Australia continues to insist on these immunities being in place before deployment.

The underlying rationale for the ECP has also not been made public. However, the allocation of ECP funds suggests it is reasonable to infer the following. The poor law and order situation in Papua New Guinea is seen as one of the highest, if not the highest, development priority to be addressed over the medium term. Within this time frame, it is considered that the best returns will be provided by direct intervention in the law and order sectors to improve management practices and training standards. Improved management of the fiscal agencies is also a priority area, presumably because better budget management is seen as offering critical support across



a range of important portfolios such as education, health and transport.

### Will the ECP work?

A recent evaluation of the contribution of aid to Papua New Guinea's development since independence highlighted the substantial long-term gains made in the quality of life (AusAID 2003a). The study identified the poor rate of income growth as the main weakness in Papua New Guinea's performance. The country's human capital has improved substantially but this has failed to produce the high levels of income growth seen in comparable countries. Likely explanations are some potentially controllable problems, such as weaknesses in governance and in physical infrastructure, and poor law and order; but there are also other constraints that are harder to deal with, such as ethnic diversity and the harsh physical environment. There are no surprises in such a finding—it is already widely accepted.

New efforts to overcome these hurdles to development are of course worth considering. But there is considerable uncertainty as to which hurdles are the most critical or if and how they can be usefully addressed. What is the view of development underlying the ECP?

The ECP appears to rest on the view that there are potential flow-on benefits to be realised from better management and administration of the National Government budget, of police stations, of prosecutions of alleged corruption, and so on. The proposition also appears to be that improved governance will trigger much better returns from the existing budget expenditure on education, health, and other areas. This approach would be in line with the view widely held within the donor community that improved governance is critical to achieving better

returns from aid and in sustaining development. At an intuitive level the arguments underlying this view are appealing, and it appears a reasonable starting point from which to develop an aid strategy.

But it is important to keep in mind that the econometric work that spurred adoption of the pre-eminence of governance is potentially shallow (Easterly 2003 and AusAID 2003b:15). An ongoing rapid assessment of the impact of aid in the Pacific has found that substantial development gains have been achieved since the mid 1970s even in environments characterised by poor governance (Papua New Guinea being an example). Hence the regional experience may suggest that improving basic service delivery in Papua New Guinea can do much to lift living standards, even given concerns about the state of governance.

If this is the case, it is reasonable to question whether all of the very large increase in funding provided by Australia should be allocated to direct interventions in government agencies. It is possible that the governance initiatives of the ECP are before their time and that such high unit-cost interventions will only provide value for money once essential 'building blocks' are in place (for example, a well educated population, reasonable access to markets and essential services, and a sense of nationhood in government). Identifying the required building blocks and helping to ensure these are in place is probably more important than what may only prove to be an alleviation of the symptoms of the development problem. If donors were to develop a phased, sequenced approach to helping improve governance in Papua New Guinea, it is possible that the direct interventions in the formal system of government funded by the ECP may be at the end of the process and not so close to the start.

The ECP appears to rest on the expectation that there are administratively based,



relatively quick fixes to the governance problem in Papua New Guinea. This confidence in quick fixes is apparent in the rush to place staff before project design processes had been completed. Although there has been discussion of a long-term commitment by Australia, the planning horizon of the ECP is limited to five years with no apparent discussion of the sequencing of linked initiatives. A five-year period of governance intervention is a short intervention when seen in the context of the decades required to build an environment of good governance.

There is also an issue as to who the beneficiaries of the ECP are likely to be, and whether it can do much to alleviate poverty. Most of the ECP funds are to be used to place police in the main urban areas on the basis these are the areas with the highest reported crime. It is reasonable to expect the extra management skills and resources to be offered by the ECP to reduce crime in the urban centres.<sup>5</sup> But will this help the economy and development? Studies of living standards show that urban centres are the elite areas of Papua New Guinea, despite their major law and order problems (World Bank 1999 and National Statistical Office 2000a,b). Much of the direct benefits of the ECP will be captured by those already relatively well off.

Moreover, there are good reasons for expecting only weak flow-on effects to the majority of the population who live in rural areas. The drivers of the economy are mining and oil and other export activities, mainly agriculture but increasingly fishing. These activities are found outside the main urban areas, so they are not in the worst areas in terms of the breakdown in law and order. The main urban areas act as support centres and activity in these areas tends to follow the main economic drivers. It is unclear to what extent the main economic activities would benefit from reduced crime in Port Moresby and other urban areas. How will

the very poorly developed, remote areas of Saundau, Gulf and Madang Provinces be affected? While the main urban areas have a high-profile crime problem, the benefits of addressing this under the ECP may be mainly captured by a small, well-off share of the population.

Putting aside these fundamental issues of how best to assist the process of development, there is a range of more immediate factors that will influence whether the ECP works. Some of these factors are discussed below.

### **Is there government ownership?**

One of the key lessons from donor-sponsored reforms worldwide is that the success of governance initiatives rests on the recipient government 'owning' the reforms.<sup>6</sup> That is, the potential for the ECP to improve governance is dependent upon the support of the Papua New Guinea government and bureaucracy.

Although publicly portrayed as a joint initiative, the ECP is best described as an initiative of the Australian Government. It emerged in an environment of tension and in the absence of a crisis that would create an environment in which its potential contribution may be better received. The ECP has been offered without any conditionality and against a background of a clear indication from Australia that it does not see itself ever being able to walk away from Papua New Guinea. This suggests that the Papua New Guinea Government is unlikely to place the same priority on the ECP as does the Australian Government and the internal pressure to maximise the benefits from the ECP may be weak.

There can often be differences in understanding between donors and recipient governments as to the details of an agreed direction, and the detail of the ECP is yet to



be fleshed out. Already there has been a delay of at least six months in much of the implementation, resulting from the adjournment of parliament. Papua New Guinea's prime minister indicated in late February that he may not agree to provide Australian police and judges the immunity from certain laws they are seeking before being deployed.<sup>7</sup> This latest development seemed to arise from a desire to respect Papua New Guinea's sovereignty; feelings that are unlikely to fall away quickly, particularly in an environment of an approaching vote of no-confidence. These developments so early in the ECP suggest it may face the same sort of prolonged delays and negotiations that have characterised other major donor-sponsored reform efforts of recent years.

Even once deployed, the positions funded under the ECP will face an ongoing challenge in developing and maintaining support. It may be thought that the placement of Australians in line positions safeguards their contribution, but it is a simple matter for even those in in-line positions to be sidelined; for example, by excluding them from decision-making or information sharing or, in the case of a police station, by staff not talking English. In the hypothetical case where a questionable expense is to be authorised, but an Australian staffer refuses to do so, in theory it would be a simple matter to divert such approvals to a more senior officer (it is understood that no Australians would hold a position as head of agency). Whether the ECP will work will rest heavily on how the individual placements operate to gain support from their local colleagues.

### **Is the mode of delivery right?**

A useful indicator of whether a technical assistance initiative is likely to work is the number of times it has been tried before. Unless the reasons for past failures are

identified and addressed, the likelihood of success of another attempt is probably low.

The placement of foreigners in in-line positions was widespread in colonial administrations. The potential downside of such placements was well recognised and one of the key initiatives at the time of independence was cutting back on such inputs. They have generally been avoided by donors in the region since then. Not only do line positions directly displace local input because positions are filled by outsiders and thereby prevent learning by doing, they also run the risk of indirectly degrading local capacity by reducing the need to build such capacity and the incentives an individual faces to develop skills. On the positive side, in-line positions provide an opportunity for the placements to work closely with staff and transfer important technical and management skills, a typical means of developing skills in any bureaucracy.

The ECP is based on the premise that the critical tasks to be undertaken are currently beyond the capacity of Papua New Guineans either within the public service or those that could be drawn from outside. Even if this is the case, there is a range of options for responding to the capacity shortfall. The findings of an Asian Development Bank review of its experience in facilitating economic reform in the Pacific are insightful.

Consultants and external advisers are often engaged for economic advice and capacity building. However, the results are far from encouraging. Some programs have been in progress for more than three years, with many thousands of dollars spent on consultants, but with little to show in institutional and human resource capacity building. Some important issues and related lessons have emerged from the Pacific experience. First, given constrained human resources capacity in the Pacific, the need for consultants





is often inevitable. However, there are options in regard to how they can be used: as long-term advisers, in line positions; or as short term, periodic inputs. These options must be carefully evaluated, keeping in mind at all times that the reform program must remain locally owned and managed. A key indicator of consultant effectiveness should be the extent of local ownership he or she is able to engender. Second, it is important to clarify whether the consultant is fulfilling a line function or whether the mandate is to build capacity. If it is the latter, technical expertise is not a sufficient qualification for the job. Proven success in transferring skills and supporting participative capacity building are essential requirements. Third, the Bank must assure the government that the consultants it offers have the right breadth of experience and demonstrated exposure to a variety of reform approaches. Otherwise, there is the substantial risk that reform approaches adopted by the country are dictated not by disciplined analysis of needs and assessment of options, but by the narrow experience of the long-term advice (Asian Development Bank 1999:174).

There are no indications yet available publicly that such well established lessons are being addressed by the ECP.

Moving beyond the issue of in-line positions, the ECP is yet another major attempt by donors to address economic governance in Papua New Guinea. There have been three donor-sponsored structural adjustment programs over the past 15 years. The most recent program was notable for placing a high priority on addressing needs in the central agencies.

In recognition of the erosion of the integrity of public institutions, the government has focused much of its attention on a broad program to strengthen the civil service, improve public sector performance, and combat fraud and corruption. This has included, among other areas, budget reform, reviews of the Cabinet secretariat, the Office of the Prime Minister and the Public Service Commission and pursuit of high level corruption cases. The accomplishments to date already constitute a sharp break with the past (World Bank 2000:7).

All structural adjustment programs have been completed, in terms of compliance with loan conditions. But the main issue has been the sustainability of the initiatives, with budget responsibility in particular slipping quickly after completion of the program. The World Bank itself rated the outcome of the 1990 program as unsatisfactory and for the 1995 program as only marginally satisfactory, with sustainability rated as unlikely and uncertain respectively (World Bank 2000b:ii). The widespread concerns over the continued deterioration in service quality and increasing corruption are reflections of the difficulty of achieving sustainable change in the operation of government. The need for the ECP after so much effort has been spent addressing concerns in governance is, in itself, an indication of the difficult environment in which the ECP will be operating and suggests a cautious and studied approach.

Australia has been providing assistance to Papua New Guinea's law and justice sector since 1984, with the sector accounting for one-third of Australian program aid by 1991. Support for the police force accounted for two-thirds of this aid (AusAID 2003a:36).



The change in direction marked by the ECP suggests that the previous support is considered inadequate. What is unclear is whether past experience makes a clear case for the placement of up to 230 Australian police. If a sector has received considerable support but seemingly with less-than-satisfactory impact, it seems prudent to try new initiatives with caution and to test their likely performance carefully. A single step to a major new commitment based on an experimental mode of intervention would appear to carry considerable risk in a poorly performing sector.

The ECP marks a break from past donor attempts to spur major reforms in one very important respect. There is no conditionality attached, no milestones for the government to achieve before receiving additional support. This break is difficult to rationalise as 'learning from the past'. The hope appears to be that the inside position held by Australians will provide a special relationship and understanding that will enable Australia to use diplomacy to encourage better outcomes. But this is certainly not the first time that donors have been able to obtain good internal information on government operations, and it remains to be seen whether Australia can capitalise on its placements as hoped.

While Australia has made a substantial financial commitment to Papua New Guinea without conditionality, the World Bank and the Asian Development Bank are still working through the consequences of recent non-performance. Concerns over the quality of governance in the forestry and fishing sectors in particular have caused considerable tension with the government. In the case of the Asian Development Bank, the second tranche of US\$35 million provided as part of a public sector reform loan has been deferred for more than a year and may not proceed. In

the case of the World Bank, its Forestry and Conservations Project has faced prolonged delays and the full start-up is at risk. During 2003 the main donors to Papua New Guinea agreed to prepare a joint country strategy. The ECP has been prepared outside this process and reflects markedly different views on how to encourage governance reforms. The reasons for this divergence in approach within the donor community are unclear.

### **Is the Australian policy model the right one?**

Donor interventions to build governance typically build on policy or operational models taken from elsewhere. In the Pacific, for example, the New Zealand and Australian experience with budget reforms had a major impact on the evolution of budget systems during the 1990s.

But there is a potential problem in adopting someone else's policy model.<sup>8</sup> The appropriate role of a foreign adviser is to facilitate a process that allows for the emergence of a policy initiative or administrative mechanism that solves that system's specific problems to address the objectives of the system. Advisers should generally avoid acting as decision-makers, because in all but exceptional cases foreign advisers do not adequately appreciate the intricacies of the systems with which they are working. This is, in part, because of the complex interplay between cultural factors and how governments work, and also because they normally do not have enough time working with a system to understand it adequately.

In the first instance the policy initiative or administrative mechanism should be designed to work within the existing capacity, particularly in terms of the capacity of staff. It is sensible to try and make a response more



sophisticated over time, but this is best done in a phased way and only after it is clear that the building blocks required for the next phase are in place. An appropriate example is that of a ministerial adviser. The ministerial adviser must work within the limits of the minister because it is the minister who makes the decision to go ahead with a proposal and who must gather support from other parties. Foreign advisers, like ministerial advisers, should be seen and not heard and work in a supportive role only, avoiding the tendency to place too many demands on local capacity.

The donor community typically finds it easier to sponsor the transfer of someone else's model than to develop a new one. Knowing up front what will be transferred makes it easier for donors to define milestones and performance agreements, and help in dealing with the situation where donor staff may lack the technical skills or practical experience in the area they are overseeing. But models developed elsewhere have emerged in response to the problems and objectives of a different system and, importantly, are subject to the available capacity of that system. Unless similar conditions are in place in the recipient country, straight transfer can create problems.

The drawbacks of importing Australian approaches have been highlighted by recent developments in the regulation of telecommunications in Papua New Guinea. May of 2003 saw a near three-fold increase in call charges from Australia to Papua New Guinea. The new rate of A\$2.20 per minute is substantially above the typical rate for a call to the South Pacific of around A\$1 per minute. Within the surrounding region, only the newly established telecommunications system of Timor Leste (East Timor) costs more to call from Australia, at A\$3 per minute.

The problem has arisen because the regulatory contract reached between the government and Telikom Papua New Guinea failed to identify incoming international calls

as a monopoly area and to regulate the relevant tariffs. This provided Telikom the flexibility to almost triple its prices on incoming calls from Australia. The regulatory contract prevents a renegotiation of its scope without compensation, and this leaves Telikom well placed to earn very high profits on its international business, possibly by increasing international call charges even further.<sup>9</sup> Telikom is now well placed to use the excess profits available on the overseas service to cross-subsidise other parts of its business so as to deter potential competitors.<sup>10</sup> To illustrate the potential benefits of competition, Tonga now has two telecommunications providers and is offering much lower prices than Papua New Guinea despite having a smaller population.

Regulatory contracts are a relatively sophisticated form of utility regulation and will normally only provide efficient regulation when backed up by a robust regime of independent review and monitoring. Regimes capable of supporting regulatory contracts or agreements used in Australia have been built up over many years and can draw on considerable technical capacity and a well functioning judicial system. These preconditions are not in place in Papua New Guinea, and their absence suggests that only simple regulatory approaches should have been adopted for the utilities at this stage.

As the designers of the ECP and the placements are to be drawn from the Australian public service, it is reasonable to expect them to gravitate quickly towards replication of the Australian approach. One of the attractions of project teams drawn from a variety of country backgrounds is that they are more suited to drawing on the experience of a range of countries. But the ECP team does not offer such a diversified background. As full-time public servants from Australia with potentially little developing country experience, they may have too little practical experience in such policy transfer to identify



potential pitfalls. How well they deal with this issue is likely to have an important bearing on how well the ECP works.

### **Is the Australian institutional environment suitable?**

As a general rule, well thought-out and warranted economic initiatives are backed up by publicly available analysis developed through a process of open consultation. For example, much of Australia's microeconomic reform program was developed and reviewed in such a manner with the work of the Productivity Commission and its predecessors setting an internationally recognised benchmark for accountability. The ECP and surrounding policy has been developed rapidly and, with the exception of AusAID, by agencies with little experience in delivering development projects in Papua New Guinea. Under such conditions it is sensible that appropriate safeguards be in place to ensure funds are spent well.

However, the documentation and opportunities for public and peer review are sparse. Unlike a normal aid initiative, the ECP is being designed as it is being implemented after key decisions have been made. This has left gaps in the planning process and documentation and it is difficult to pinpoint the thinking and analysis underlying the initiative. There is, for example, no document explaining why this initiative will do better than past economic governance initiatives or past assistance for the Papua New Guinea police. There is also no document explaining how the lessons learnt by Australia and other donors in Papua New Guinea and elsewhere have been interpreted and built on.

It is possible that this situation will be corrected during 2004, and certainly the key agencies have foreshadowed that much work is underway to develop the initiatives

fully. Whether this is done and the package can be seen as at the forefront of development thinking will be an important test of Canberra's new aid team.

One of the risks to be factored in is the conflict of interest facing key agencies. One of the principles of AusAID's aid management is that the agency maintains independence from its suppliers and this helps provide objectivity in the review of performance. But this principle has not been applied to the ECP. Most agencies will be reviewing their own performance; the main agency affected being the Australian Federal Police. AusAID is the only agency not facing a major conflict of interest through the provision of its own staff to the ECP, but it is only one member of this team and is only involved in the economic governance initiatives. Can AusAID be sufficiently independent in reviewing the work of other public servants, will the Australian Treasury or Department of Finance be sufficiently objective in reviewing the contributions of their own senior staff? And who is overseeing the Australian Federal Police?

It is reasonable to question whether policy agencies should have allowed themselves to also become service providers. The Australian Departments of Treasury and Finance have critical policy responsibilities that only they can undertake, particularly in helping supplement AusAID's economic resources and guiding strategic decisions on the pursuit of good economic governance, so maintaining the impartiality of their advice is very important. There are good reasons why over the 1980s and 1990s Australian jurisdictions put so much effort into separating the roles of policy advice and service provision, and it is unclear why Australia's aid delivery has moved in the opposite direction.

Underlying the new approach to aid is the classification of aid delivery as a core function of all Canberra agencies. This



classification legitimises the new and expanding role of agencies such as the Australian Federal Police, Treasury, Finance, Customs and the Australian Tax Office as service providers. In testing the rationale for this reclassification, it is appropriate to draw on the economic principle used to define the role of government. That is, to consider the market failure or equity rationale for government intervention.

Clearly the provision of aid is heavily influenced by equity considerations, being the desire of Australians to transfer resources to those countries perceived to be less well off. This provides a rationale for the provision of aid, but does not affect choices on the mode of delivery. Choices on the mode of delivery can usefully draw on the market failure rationale, in this case the presence of information failures. In any contracting situation a point can be reached where the transactions costs are so high that internal provision is optimal. This, after all, is one reason why firms exist.

Do such arguments apply in this instance? Certainly there is a problem in overseeing consultants working on governance initiatives. There can be long lags before any impact is discernable and, even after some time, the outcomes of governance support are often unclear. But this information problem applies equally in reviewing the performance of consultants or public agencies, and both have a strong incentive to achieve a favourable review. It is reasonable to argue that the problem may even be greater under the ECP because of the grant of monopoly rights of supply to public agencies. In effect, new government monopoly businesses have been created without the standard checks and balances.

## **An in-principle critique**

### **Cost-benefit considerations**

All public expenditure initiatives should be able to satisfy a cost-benefit test of generating benefits that exceed the costs. The initiatives funded should normally be those that offer the highest benefits for every dollar spent (that is, initiatives offering a higher benefit to cost ratio should generally be favoured over those offering a lower ratio). When these conditions are met, the proponent can be confident that the expenditure is welfare enhancing and that the best expenditure initiatives have been chosen.

There is no reason why the ECP should be excluded from satisfying such fundamental tests. However, there is no documentation available publicly to show that these tests have been satisfied or even considered. This is surprising for such a large expenditure commitment based on a very different approach and made in a high-risk environment. The absence of such information represents an important gap in accountability and transparency. It is possible that the work underway to implement the ECP will see the missing analysis undertaken. This section explores some of the issues that should be considered in conducting such tests.

### **The benefits**

The considerable uncertainty as to whether the ECP will work and whether it is addressing the key impediments to development will make it very difficult to quantify the potential benefits. But a sense of the quantum of benefits that have to be generated by the ECP to make it a sensible choice can be provided by considering competing expenditures. That is, to explore what else could be achieved with the A\$1 billion commitment.

The annual cost of the ECP is more than K500 million at current exchange rates. This will be the equivalent of the order of 20–25 per cent of the Papua New Guinea Govern-



ment's recurrent budget. In an environment of tight expenditure constraints, this is a sizeable expansion in funding and the size of the Papua New Guinea public sector. The funds allocated to the ECP are substantial compared to the cost of the main Papua New Guinea budget sectors. For example, the annual cost of the ECP is 0.8 times the total allocation to the education sector in 2003. Of this allocation to education, a substantial portion is spent on tertiary education, where, in line with international thinking, the government's medium term development strategy prioritises basic education. The estimated cost of tertiary education is approximately K150 million in 2003, so the annual cost of the ECP is slightly higher than

the current cost of secondary, primary and elementary education (Table 2).

If the social cost of a kina spent on the ECP and lower levels of education were the same, the ECP would need to generate benefits of a similar magnitude to those generated by the lower levels of education, if the ECP was to be comparable in terms of its contribution to development. The lower levels of education had almost 700,000 5–19 year olds attending in 2000 and attendance has probably continued to grow since then (2003a:47). Enrolment rates are still low (Table 1) and there is considerable potential to expand and improve the standard of the education system and the critical contribution it makes to development in Papua New Guinea.

Table 2 The ECP and the expenditure options (million kina)

	Annual funding commitment (million kina)
ECP	
Police	420
Other commitments	105
Total commitment	525
PNG budget sector (in 2003) <sup>a</sup>	
Education services <sup>b</sup>	637
Elementary, primary and secondary	487
Health services <sup>c</sup>	434
Law and order	251
Agriculture and renewable natural resources	98
Transport and communication	325

<sup>a</sup> This includes government and donor funding.

<sup>b</sup> Based on the development and recurrent cost of education to the national government on a functional basis plus teacher salaries, which are paid by the national government on behalf of provincial governments. This excludes any expenditure on education funded by Provincial Governments from non-salary grants or internal revenue (such funding is understood to be small).

<sup>c</sup> Based on the development and recurrent cost of health services to the national government on a functional basis plus the half of the cost of non-teacher staffing costs paid by the national government to provincial governments. This excludes any expenditure on health funded by provincial governments from non-salary grants or internal revenue (such funding is understood to be small).

Source: Papua New Guinea, 2003, *Budget Papers*, Volume 2: Part 1, 2004 Recurrent Budget Estimates of Revenue and Recurrent Expenditure of National Departments and Volume 2: Part 3, 2004 Estimates of Development Expenditure of National Departments, Statutory Authorities and Provincial Governments.



Or to put this another way, the 300 ECP placements and associated activities will cost more in a year as providing one year's education to around 700,000 Papua New Guinea children. Drawing on the average unit cost to the government of education of 2001, the funds allocated each year to the ECP appear to be of the order required to fund universal primary education on an ongoing basis.<sup>11</sup>

The annual cost of the ECP is also more than is normally spent each year on the law and order, infrastructure, and health sectors. These sectors also set important benchmarks for the ECP.

The police component of the ECP alone (K420 million) is 30 per cent more than is spent annually on the entire law and order sector. For the ECP to match the performance benchmark set by the law and order sector, in very broad terms the 230 police and other support to be funded from the ECP need to exceed by 30 per cent the contribution made by the 5,500 police in Papua New Guinea, as well as the existing judiciary and corrective services.

The annual maintenance requirement for a rehabilitated national, provincial and district road network has been estimated to be in the order of K200 million per annum, with the cost of rehabilitating the network estimated at up to K2.7 billion (Papua New Guinea and World Bank 2003:iv). For practical reasons the required rehabilitation works would need to be spread over a number of years. If all rehabilitation works were to be spread evenly over the next ten years, the annual funding allocated to the ECP would be of the order required to fund the annual maintenance and rehabilitation needs of the main road network and feeder roads for the next five years. Road maintenance has been estimated to offer a benefit to cost ratio of more than three in Papua New Guinea, illustrating the substantial potential benefits available from spending K500 million on the road system (AusAID 1999).

Immunisation rates in Papua New Guinea remain low, at less than 60 per cent (AusAID 2003a:4-5). Immunisation is a very low cost way to raise living standards and, at this stage of Papua New Guinea's development, is a high priority for additional funds. It is estimated that there are in the order of 2,000 health facilities in Papua New Guinea. On average there are approximately 4,000 persons per aid post or health centre, but in 10 per cent of districts such facilities service more than 6,000 people (based on data from National Economic and Fiscal Commission 1999). The adequate funding and operation of these basic facilities is also a very high development priority at a time when service delivery is generally seen to be in decline.

Thus the ECP will have to be very successful to match the development returns being achieved or on offer by other sectors.<sup>12</sup> It is important to keep in mind that improving the law and order problem may not just mean more or better working police. Government initiatives such as hastening the achievement of universal primary education, or raising the quality of teachers, or providing basic medicines to health facilities, or raising the immunisation rates have the potential to make a stronger contribution to the law and order problem and development more broadly than improved enforcement of the laws.

### The costs

As funding of the ECP is provided on a grant basis, there is no direct cost to Papua New Guinea from the initiative. But there can be important indirect costs if the package has an adverse influence on the behaviour of the Papua New Guinea government. In this respect, perhaps the greatest risk is that the ECP and surrounding commitments will defer a decision by the Papua New Guinea government to correct the wage and salary bill and to act to relieve the pressure on funding for goods and services.



Donors are normally very reluctant to fund recurrent costs, particularly goods and services. Faced with concern over the deterioration of services, in recent years AusAID now funds recurrent activities, including goods and services. AusAID is now the main source of funds for road maintenance (but even so, funding only covers around 25 per cent of the national road network), is a very important funding source for medicines and other recurrent costs through the Health Sector Improvement Program, and has been funding the bulk of costs associated with implementing the education reforms (AusAID 2003a:33–46).

AusAID's decision has been an important step towards protecting the living conditions of many Papua New Guineans. But it carried the risk that it would be indirectly undone through laxness elsewhere in the budget. This is the problem of fungability—a very difficult problem to manage. If the benefits of Australian aid for basic services were to be maximised, it is likely that action would be needed to manage this risk.

The risk of Australia indirectly supporting laxness in Papua New Guinea's budget has potentially increased through ECP funding of recurrent costs. The ECP and associated policies give a clear message that Australia will stand by Papua New Guinea, given its strategic importance to Australia's defence and concerns over the threat of terrorism. In part, this is because of the absence of substantive conditionality on the ECP, an outcome noticeably in contrast to the Australian prime minister's indication in the middle of 2003 that aid would be linked to action to address corruption. It is also surprising given that the recent Public Expenditure Review spelled out some of the key problems facing the budget and the administrative steps that can be taken to address the problems—such as the inflated wage and salary bill. If the Papua New Guinea Government is not prepared to take

such action, it is appropriate to question the potential for a general improvement in governance.

There is an alternative means of addressing the wage bill issue. The Papua New Guinea government has been successful in limiting public sector wage increases to less than the rate of inflation (which is roughly equal to the rate of decline in the kina). As the kina has fallen so have real wages. At the same time the large inflow of foreign currency-based revenue offers a natural hedge to the budget such that a falling kina improves the budget position (as long as wage increases are restrained). Public expenditure laxness, which is the key contributor to the fall in the kina, offers a form of automatic stabiliser because it lowers the real value of the wage bill.

Unless donors, Australia in particular, are prepared to encourage the government to address the wage bill problem through formal, administrative means, it may be preferable to allow this automatic stabiliser to continue, as it has since 1994. This outcome could be encouraged by offering only parsimonious support for economic management in the knowledge that fiscal crises would be more likely. This approach could see continued fiscal crises over a five or ten-year period give a sharp shock to the economy, which could then be allowed to adjust.<sup>13</sup> While this would be a difficult adjustment path, it may be preferable to pursuing a long drawn-out process of adjustment characterised by service deterioration in an environment where assistance to economic management is hamstrung by the imbalance in the budget. There is a risk that the ECP is helping direct the economy down this latter adjustment path by deferring action on the wage bill.

Australia's recent actions send the message to the Papua New Guinea Government that it will receive a favourable hearing from Australia during difficult





periods, and this will tend to ease perceptions of the need for reform. It also tends to lessen the opportunity for the Papua New Guinea Government to shift the blame for some difficult decisions to the donors, a potentially useful technique for pursuing reform that is politically unpalatable.

There can also be flow-on costs to the activities of other donors if it lessens their ability to use their funds as leverage for reform. The World Bank, Asian Development Bank and the International Monetary Fund place considerable effort on conditioning the provision of support in an attempt to improve governance. If it works, the ECP will potentially relax the government's budget constraint and therefore potentially also its need for support from these agencies. In the past Australia has tended towards a more lenient response to Papua New Guinea than these other agencies, as evidenced for example by its provision of a large swap in

the early stages of the previous structural adjustment program. If Australia is disposed to provide a lenient response, this could undermine the potential for other agencies to encourage reform.

Further costs to be considered are the potential for the ECP to undermine the development of local capacity (as noted above), and whether Australia's unilateral actions in an environment at a time when improved donor coordination is being pursued have disturbed donor relations.

#### Cost-effectiveness considerations

A cost-effectiveness test asks if there are lower-cost ways of achieving the policy objective. For the ECP to be sensible, it must pass the standard test of being the most cost-effective means of meeting the objective.

The challenge facing the ECP is the high unit cost of its inputs. The average level of funding (for wages and salaries and goods

Table 3 The ECP and the expenditure options

	Number of staff	Estimated funding for salaries and goods and services per staff member (kina)
ECP		
Police	230	1,830,664
Other commitments	66	1,594,896
Total commitment	296	1,778,094
Key national agencies		
Education	42,040	15,152
Health and hospitals	5,170	83,994
Police and judiciary services	6,499	38,667
Works	2,137	151,989
National and provincial departments		
Total national departments	67,233	..
Provincial administrations	10,552	..
Total	77,785	21,547

Source: Joint Statement of the 15th Australia-Papua New Guinea Ministerial Forum, Mt Lofty House, South Australia, 11 December, 2003; Public expenditure review and rationalisation, civil service size and payroll, Discussion Paper 2, 2003 July; and Table 1.



and services) per placement is approximately K1.8 million per annum. Some of this is made up of goods and services that need not necessarily be linked to a placement. But the salary cost, the cost of accommodation and support in Papua New Guinea, travel costs, and support in Canberra is substantial. In contrast, the average level of funding per Papua New Guinea public servant is approximately K22,000 per annum (Table 3).

The substantial difference in unit costs means that the Australian input needs to be much more productive than that of the local staff. As a broad indicator, one Australian staff member has to produce the equivalent value of 80 local staff to offer good value for money.

This is only a broad indication—the actual ratio would depend on the alternative expenditures being evaluated. For example, it is reasonable to argue that better education can offer a sustainable improvement to governance. The ECP will offer a better option if each placement can, on average, generate a bigger beneficial impact on governance than provided by the work of 100 teachers.

The decision that the ECP will only provide support via the placement of Australian public servants is significant. The implication is that Papua New Guineans, non-Australians, and those Australians currently outside the public sector are unsuitable. If it was considered that there were suitable candidates from this pool, the open tendering of work would have been provided.

The decision not to go to the market and to consider non-Australian public servants appears to rest on the view that the development of relationships between Papua New Guinea and their equivalent Australian agency offers important benefits that individuals or consulting firms cannot provide. There also appears to be a broader concern about the quality of services provided by consultants, and in particular, the conflict of interest they face in reviewing their

performance and informing decisions that may affect their future engagement.

The counter arguments would include the observation that many former public servants are now operating as private suppliers and that Australian practices are normally not directly transferable to different environments. If Australian public servants are the best equipped to undertake such tasks, this would be made clear by a competitive tender process.

The decision to avoid competition in supply, with Australian public service agencies given the monopoly right to provide services, is at odds with the recent untying by AusAID of its technical assistance. Only in October 2003, AusAID allowed non-Australians/New Zealanders to work as team leaders or comprise the majority of technical assistance teams. AusAID's new policy is that such services are to be undertaken by the best equipped, regardless of nationality.

## Conclusion

Governance initiatives have quickly grown to prominence in the 1990s in the portfolio of most donors. Within the region, initial efforts sought to apply the traditional project approach to governance, but more sophisticated approaches have developed. Nonetheless, the worth of these initiatives remains unclear and it may be some decades before the donor community has found robust means of supporting governance. The magnitude of the ECP and its new approach to the support of governance based on the provision of services by Australian public servants makes it a package worthy of ongoing scrutiny.

The types of governance initiatives favoured by donors typically have high unit costs, and this description fits the ECP. For example, the placement of 300 Australian public servants under the ECP will cost as



much in a year as providing one year's education to more than 700,000 Papua New Guinea children. It is reasonable for such a package to satisfy normal cost-benefit considerations or at least a cost-effectiveness test. But there is considerable uncertainty as to whether the ECP offers a sustainable solution to the underlying problems. Instead it may be limited to offering a temporary relief to their symptoms. The very high opportunity cost of the package, the decision to provide support without conditionality and the absence of vigorous competition in the supply of services also cast doubt on the ability of the ECP to meet these tests.

There is, as yet, no framework in place to monitor the performance of this A\$1 billion program, nor is there adequate documentation of the rationale or nature of the program. Whether project documents are prepared and publicly released will be one of the early tests of the ECP. Standard donor documentation, such as those prepared for the World Bank loans and by the International Monetary Fund to accompany their standby facilities set reasonable benchmarks to measure the ECP against (see, for example, World Bank 2000a,b). It is now important that steps be taken to fill gaps in the accountability and transparency framework arising from the absence of standard project documentation and an independent monitoring regime.

The main concern about the ECP relates to the police component. Although the economic governance initiatives are not being led by the Australian Government's most experienced aid-delivery agency, AusAID, they are being jointly prepared by a range of agencies with relevant competencies. The main cost component of the ECP, the A\$800 million police component, is being prepared solely by the Australian Federal Police. It appears reasonable to ask whether the Australian Federal Police is well suited to dealing with the community-level policing

required in Papua New Guinea, an area of policing that mainly falls to the state police, and whether the Australian Federal Police should deliver aid activities at all. The absence of AusAID and other agencies in the design and monitoring of the police initiatives are further reasons why this is the main component of the ECP to warrant scrutiny.

## Notes

- <sup>1</sup> The lower estimate is the usual measure based on the government accounts while the higher estimate is based on data from the banking system on the financing of the deficit (Papua New Guinea 2004).
- <sup>2</sup> Note that it is possible that personnel costs may not be fully recorded and this understates the full wage and salary bill.
- <sup>3</sup> The interpretation of the infant mortality rate is complicated by uncertainty in the quality of the underlying data. The National Statistical Office review of the infant mortality data concluded that there 'are indeed some reasons to believe that the 1980 infant mortality rate may be more of a minimum index of infant mortality than the ones for 1991, 1996 and 2000' and that 'it is clear that, after 1980 there has been relatively change in infant mortality' (National Statistical Office 2003a:32).
- <sup>4</sup> This overview of the ECP is based on the Joint Statement of the 15th Australia-Papua New Guinea Ministerial Forum, Mt Lofty House, South Australia, 11 December 2003, accompanying press material and consultations in January with AusAID, the Commonwealth Treasury and Department of Foreign Affairs and Trade.
- <sup>5</sup> Note that recent announcements of a review of the RPNGC have highlighted the problems for police performance that may be created for police morale by low pay rates and poor accommodation (see *Post Courier*, February 20, 2004:16). Placement of Australians in line positions will not address such problems. This highlights the importance of designing an intervention to address identified problems



rather than being based on what the funding agency is comfortable to provide.

- <sup>6</sup> For a regional perspective on this issue, see the findings of the Asian Development Bank's review of its support for economic reform in the Pacific (ADB 1999:169–76).
- <sup>7</sup> In an interview with the Australian Broadcasting Corporation as reported in the *Post Courier*, 27 February, 2004:3.
- <sup>8</sup> Also see Larmour (2003) for a discussion of policy transfer issues in the Pacific.
- <sup>9</sup> Telikom is to be privatised over 2004 and without correction of this flaw in the regulatory arrangements. It is reasonable to expect any future private owner to aggressively exploit any unregulated market power it holds.
- <sup>10</sup> Note that there is now some doubt as to when Telikom's statutory monopoly is to be removed.
- <sup>11</sup> Note that there are concerns that the level of funding on which these estimates are based are insufficient to ensure an acceptable standard of education.
- <sup>12</sup> As a marginal expenditure, the benefits of the ECP should be compared with the marginal expenditure in each sector. However there is considerable capacity to usefully expand services in each sector, and it appears reasonable to at least initially work on the assumption of constant average costs (eg the education sector is in an expansion phase so its costings embody the cost of additional investment in human capital and school buildings). On this basis it is appropriate to conduct a cost-benefit analysis by comparing the required benefits from the ECP to the rates of return on existing expenditure.
- <sup>13</sup> A concern is over this sharp shock approach, where the fiscal situation is left to deteriorate, is the risk to law and order posed by rising prices (due to the falling kina) and deteriorating government services. But it is unclear if this is preferable to the current scenario of potentially a much longer period of deteriorating service delivery. It is important to keep in mind that a falling nominal kina is beneficial for many people in rural areas, and has led to a beneficial shift of income from the urban élite to rural areas where most poor people live. So allowing

the kina to fall may be an important in alleviating poverty in Papua New Guinea.

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### Acknowledgments

Thanks go to staff of AusAID, the Commonwealth Treasury, Department of Foreign Affairs and Department of Finance for making time to discuss the ECP, and for the helpful comments provided by an anonymous referee, Satish Chand, Ron Duncan, Anthony Hughes, Ray Manning, Cedric Saldanha and Kathy Whimp. Any errors are the sole responsibility of the author.