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by

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No. 2006-9

Working Paper Series in Economics

ISSN 1442 2980

www.une.edu.au/economics/publications/ecowps.php

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Evaluating Australian Macro-Level Foreign Aid to Papua New Guinea

Danielle Heinecke, Brian Dollery and Euan Fleming**

Abstract

There is increasing recognition in the development literature that foreign aid can have malign effects on the recipient country, especially in failing states. This paper considers the impact of Australian aid on macro-level development in Papua New Guinea. After a review of official evaluations of the effectiveness of aid, the potential sources of 'aid failure' and 'aid accountability' in Papua New Guinea, it is argued that the current Australian macro-level aid program needs to be reassessed. In particular, the focus, coherence and impact on civil society of Australian aid should be modified in order to minimise its debilitating effects.

Key Words: aid; development; Papua New Guinea

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Introduction

Development aid is premised increasingly on the proposition that it can play an important role in strengthening institutions. Economists are in broad agreement that where institutions and policies are relatively robust, foreign aid can have a positive effect on economic growth. However, there is much less agreement on the effectiveness of aid where institutional failure is high - a typical attribute of fragile states. For instance, Burnside and Dollar (2004:4) have argued that in weak institutional environments substantial financial aid is unlikely to stimulate reform and thereby propel economic development, and may even retard economic and social progress. In the empirical literature, Knack (2000) has found support for this view using data drawn from an extensive sample of countries. In addition, he has argued that large aid flows delivered into countries with high levels of institutional failure can have negative effects on the quality of political institutions and governance mechanisms, including bureaucratic ineptitude, increased corruption and the erosion of the rule of law.

However, it should be stressed that Knack (2000) included conflict-afflicted countries, which tend to receive high levels of aid during the post-conflict and reconstruction phases. Accordingly, he has not conclusively demonstrated that aid actually caused the decline in institutional quality. Nevertheless, following these findings, there is conceptual and empirical evidence which suggests that heavy dependence on external finance, including aid for the delivery of government services, damages civil and political institutions.

This paper attempts to provide a general assessment of the role of Australian aid aimed at the macro-level development of Papua New Guinea (PNG) over the recent past. The paper itself is divided into seven main parts. Section 2 provides information on the budgetary context for aid inflows into PNG, with a focus on Australian aid

assistance. Section 3 distills the main findings from the various evaluations of aid effectiveness in PNG. Section 4 is concerned with the potential sources of ‘aid failure’ in PNG. Section 5 attempts to draw some firm conclusions on the overall impact of aid in influencing institutional change in terms of accountability. Section 6 assesses the impact of macro-level Australian aid and presents some tentative policy recommendations. The paper ends with some brief concluding remarks in section 7.

Foreign Aid to Papua New Guinea

PNG is dependent on foreign aid for delivery of a large majority of its public goods and services. In 2003, per capita aid to PNG was \$US40 (K133), ranking PNG as the 68th most aid-dependent country (World Bank 2003). Contrary to popular misperceptions that PNG is one of the most aid-dependent countries in the world, these data rank PNG just above the global median aid level of \$US31 per capita. This implies that PNG’s dependence on foreign aid means it faces similar dependency challenges with a significant number of other developing countries, and is thus not an outlying example. Table 1 below sets out some relevant global comparisons.

Table 1: Aid Levels Per Capita

Country/Region	Aid per capita \$US
Papua New Guinea	40
Sub-Saharan Africa Region	34
East Asia/Pacific Region	4
Low Income Countries (all)	14
Median Level (all)	31

Source: World Bank (2003)

Foreign aid to PNG accounts for 22 per cent of the 2005 national budget (PNG Government 2005). In common with sub-Saharan Africa, aid is primarily focused on

recurrent expenditure and therefore takes on many core responsibilities for service delivery. It is the primary source of external financing, with commercial loans representing a further 7 per cent of total revenues captured in the budget (Hnanguie 2002:3-4). Within this aggregate figure, Australian government aid accounts for the majority of aid to PNG. Using 2004 data, Australian aid represented around 81 per cent of international grant aid and comprised about 17 per cent of the PNG budget (Lepani, Morris and Tuioti 2004:3). Accordingly, given its comparative significance, Australian aid represents the primary, but not exclusive, focus of this paper.

The Australian aid program to PNG is delivered under a Development Cooperation Treaty which stipulates that up to AUD300 million (about K700 million) will be delivered each year. PNG is the only country where the Australian aid program is guided by an international treaty. Under this Treaty, Australia currently delivers close to AUD300 million per annum through bilateral programs. This amount represents a 60 per cent decline in real terms as a proportion of PNG's budget since PNG gained Independence – in 1976 Australian aid provided around AUD300 million or 43 per cent of the PNG budget which declined to 17 per cent of PNG's overall budget by 2004 (Lepani, Morris and Tuioti 2004:4). In addition to the AUD300 million bilateral program, Australia also delivers regional and global programs that benefit PNG. For example, between 30 and 80 volunteers are funded annually by the Australian Government to work in government and non-government agencies across the country.

With the negotiation of the Enhanced Cooperation Program (ECP) (currently under renegotiation) in 2003, it was envisaged that an additional AUD800 million (or AUD160 million a year) for policing would be provided to PNG over 5 years. The non-policing components of the package, which originally included the provision of up to 64 'in-line' (rather than advisory) Australian public servants in economic management, law and justice, border and transport security and immigration, was funded through the existing AUD300 million aid program. The ECP was a direct response to the continued weakening of PNG's systems (Potts 2004:5) and a

deliberate attempt to help curb corruption. Led by the Australian Department of Foreign Affairs and Trade (DFAT), Treasury, and Finance, ECP was also a response to a perception within the broader Australian Government that the existing aid program, delivered through the Australian Agency for International Development (AusAID), had failed.

Figure 1 below provides a break-down of Australian aid by sector (AusAID 2005a). Funding for activities specifically delivered to target PNG's core institutions responsible for governance accounts for AUD100 million of the AUD300 million program (or 34 per cent). Governance activities consume the majority of expenditure and their proportion of aid has steadily increased since 1995, reflecting Australia's concern for the quality of PNG's institutions. Within all other sector expenditure areas, such as health and education, a significant proportion of the program is focused on improving the governance of these sectors.

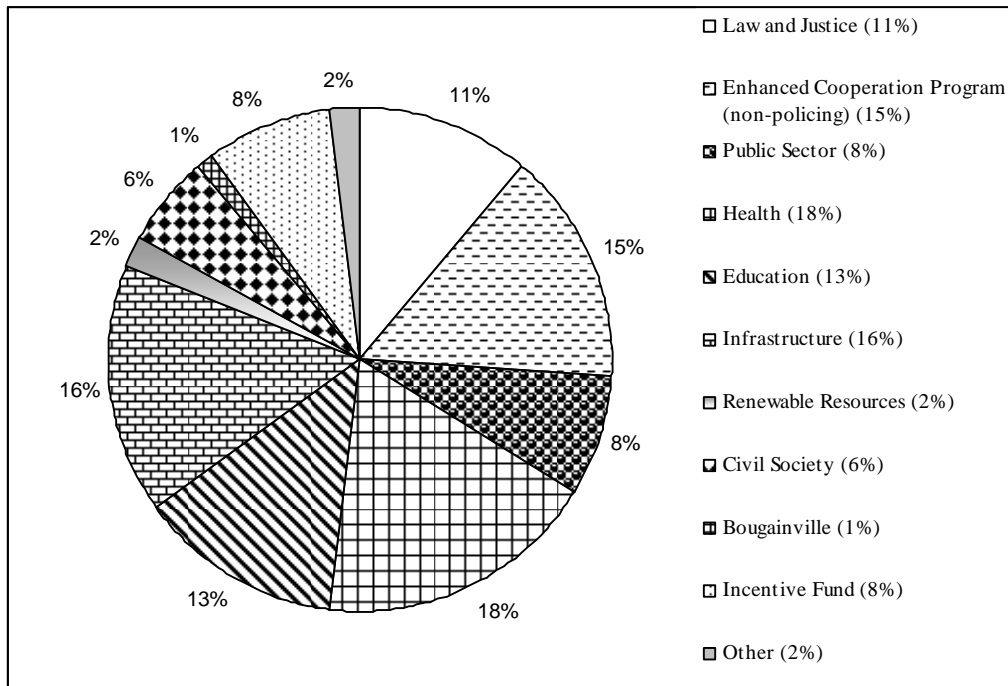


Figure 1: Australian Aid Estimates by Sector

Source: Calculated from AusAID (2005a)

The level of expenditure in PNG by the Asian Development Bank (ADB) and World Bank (WB) fluctuates around the level of loan agreements. Over the recent past, with stronger emphasis within these banks on the quality of governance and adherence to the Low-Income Countries Under Stress (LICUS) framework, the level of agreed loans has reduced in PNG. Both the ADB and the WB have cancelled loans in the past two years due to the failure of the PNG Government to deliver on conditionality in the natural resource sector (World Bank 2005:3). This has led to more grant-based programs from the banks, primarily in the areas of HIV/AIDS and community development. The European Union (EU), Japan, New Zealand and the United Nations agencies also have grant aid programs in PNG. New Zealand's program of around \$US7.2 million (K18m) works closely with Australian aid in the health sector and in the law and justice sector. Japan's \$US44 million (K110 million) is mostly targeted to infrastructure programs. The EU contributes around K70 million per annum, and is primarily focused on the agriculture and education sectors, as well as governance.

The UN programs are targeted towards democratic governance and the social sectors, including education, health and HIV/AIDS. Across all its agencies UN expenditure is around \$US10 million (K25 million) a year. However, it will be significantly increased once the Global Fund for HIV/AIDS is available to PNG.

Assessments of the Effectiveness of Aid

A number of reviews and evaluations have been undertaken of the Australian aid program to PNG. The most significant of these reviews was the *Joint Review of Australian Aid Program to PNG* (2004), commissioned by the governments of Australia and PNG, following a break-down in bilateral relations in mid-2003 over the terms of Australian aid. The review concluded that the Australian aid program had been effective, but that there was considerable scope for improving its impact (Lepani, Morris and Tuioti 2004:iv). The review highlighted the weakness of the existing performance monitoring system for jointly monitoring expenditure of total resources (Lepani, Morris and Tuioti 2004:viii-ix) and the lack of constructive engagement between the two governments (Lepani, Morris and Tuioti 2004:i). However, it did not make any observations on the role of incentives in influencing institutions.

In 2003, AusAID commissioned an evaluation of Australian aid effectiveness - *The Contribution of Australian Aid to Papua New Guinea's Development 1975-2000* (AusAID 2003). This evaluation argued that Australian aid had contributed materially to development gains in PNG. It concluded that Australian aid program had: been responsive to PNG's own development need and priorities; contributed to sectoral improvements; helped prevent instability; and stemmed the decline in service delivery.

The Report was critical of project aid delivered by all donors in PNG, and concluded that project aid had created parallel systems, led to negative institutional impacts in

the areas of capacity building and priority setting, and reduced prospects for sustainability (AusAID 2003:51). Despite these criticisms of past aid delivery mechanisms, the Report tended to attribute Australian aid to positive development gains, for example by directly contributing to increasing school enrolment (AusAID 2003:33-35). However, it assessed the negative development trends relating to declining governance and corruption as being outside both the control and mandate of the Australian aid program.

The Development Assistance Committee (DAC) undertook a *Peer Review of Australia* in 2004 (Development Assistance Committee 2005). It contended that Australia's aid program was evolving in the right direction, but suggested there were a number of key areas where Australia needed to reassess its approach. In the first place, the review argued that ECP could create tensions in terms of the Australian aid program's approach to ownership, capacity building and partnership (Development Assistance Committee 2005:94). Second, it highlighted the risks of fungibility in service delivery and the need to employ an improved framework for ensuring PNG government funding for service delivery. Third, it criticised the high levels of technical assistance being provided by Australia, which could undermine capacity building and local ownership (Development Assistance Committee 2005:95). In general, the role of aid in institutional development was discussed implicitly and not explicitly.

The WB and the ADB also undertook substantial reviews to evaluate the effectiveness of their aid interventions over the 1990s. The *World Bank Country Assistance Evaluation* (World Bank 2000:9-11) concluded that its assistance to PNG had been unsatisfactory, the institutional development impact modest, and sustainability uncertain. The WB's evaluation (2003:15) of its activities in extractive industries further concluded that projects in this sector had specific technical-centric sectoral benefits, but had not contributed to overall sustainable development in PNG. The evaluation contended that future programs in the resource sector will not lead to

benefits until there is an improvement in overall public expenditure management. It recommended that future interventions need to be targeted at the management of resource rents and policies to improve governance (World Bank 2000:18). Similarly, the ADB's *Country Assistance Program Evaluation* assessed its performance as weak in program formulation, with insufficient strategic direction and a resultant lack of coordinated project identification and design (Asian Development Bank 2003:39). The evaluation concluded that without an increase in PNG government commitment, external assistance would remain ineffective.

Hnanguie (2002:7) - a Papua New Guinean ADB economist - pointed out that since 1978 over 60 per cent of the WB's and ADB's projects were deemed to have failed. Hnanguie attributes this high failure rate to poor economic management and coordination by the PNG Government. Consistent with the 2003 AusAID evaluation, Hnanguie (2002:6-7) argued that foreign aid can be credited with 'what works' in PNG, but concluded it has been less successful at promoting sustained growth across the country. In addition to poor government coordination and implementation, Hnanguie (2002:9-10) perceived the parallel modality of foreign aid and the limited hand of government in the design, management and evaluation of programs as undermining institutional capacity in PNG.

In the light of these documents, it seems reasonable to conclude that the aid community itself has reached a broad consensus that it has had a limited positive effect on the quality of PNG's institutions. Moreover, these findings suggest that alternative approaches are necessary.

Recent academic assessment of foreign aid to PNG is also highly critical of aid effectiveness in PNG, and in the broader Pacific region. For instance, Hughes (2003) and Hughes and Windybank (2005) have argued that aid has failed in the Pacific region because it has not provided an environment conducive to economic development. Similarly, Windybank and Manning (2003:12) contended that

Australian aid was part of the problem because it had enabled successive PNG governments to 'live beyond their means, encouraging irresponsible policies and postponing the need for reform'. They concluded that AusAID risked becoming a surrogate government in PNG. Moreover, Hughes and Windybank (2005:7-8) have also attacked the high levels of foreign technical assistance focused on the state. In an analogous vein, Regan (2005:7-9) has questioned the efficacy of additional technical assistance under the ECP on the basis that state-building alone is unlikely to help PNG build a strong nation. Drawing on econometric analysis, Feeney (2005a:29; 2005b:26-30) argued that aid to Melanesia has had a limited impact on rural areas, where most Melanesians live, and has had a potentially negative effect on public revenue collection efforts because of its fungibility. Although not explicitly critical of the evolving directions of the existing Australian aid program, the Australian Strategic Policy Institute (ASPI 2004) recommended that the program should be enhanced by further strengthening the state, economy and the nation, which required an additional AUD500 million a year. It should be observed that this argument is in stark contrast to Windybank and Manning (2003), who argued that aid is already too high in PNG.

Notwithstanding some minor differences, both official aid program evaluations and the academic literature paint a bleak picture of aid effectiveness in PNG. At least three core findings can be extrapolated from this corpus of evaluative work:

- Aid has acted as a disincentive to public sector reform by funding too large a proportion of the PNG Government's core service delivery responsibilities, and has not been linked to an adequate performance monitoring system. This finding assumes that the fungibility of the aid program has decreased the accountability pressure on the PNG government;
- Aid has failed to have a sustained impact on the quality of government institutions in PNG. It has also proved incapable of providing an environment conducive to economic growth; and

- Aid has minimised the pace of deterioration in public service delivery in PNG and has thus contributed to stability. This finding presumes that aid funding for service delivery is lubricating PNG just sufficiently to prevent its complete collapse.

However, these findings all suffer from the inevitable problem of the counterfactual that faces all policy analysis: What would have happened without aid? We thus have to be cautious in drawing firm conclusions. Nevertheless, at the very least, the literature in question does suggest that major donors must reassess the effectiveness of their aid programs in PNG. However, given the recent donor focus on ‘institutions’ there is surprisingly limited explicit discussion in these evaluations on the effectiveness of institution building and the role of aid as a possible incentive in this process. In its review of the incentives in the Australian aid program, AusAID (2003) sought to examine the role of incentives in leveraging change. Although it included PNG, it only looked at one project in the portfolio, and did not examine aid as an incentive or disincentive across the entirety of the portfolio. This represents a major omission in the PNG aid literature. Incentive structures are critical and thus constitute the main focus of this paper.

Sources of Aid Sector Failure

Supply-Side Elements of Aid

Both the former *PNG/Australia Country Strategy (2000-2003)* and the new *PNG/Australia Aid Strategy Framework (2006-2010)* establish governance and reform, with a particular focus on service delivery, economic growth and the HIV/AIDS policy response, as the primary development objectives of Australian aid to PNG. The focus on building state capacity as the chief mechanism for influencing development outcomes is a key premise of both strategies. Hence, in 2005, approximately 93 per cent of Australian aid to PNG was delivered through the state,

predominantly via national agencies (calculated from AusAID 2005a). A significant proportion of technical assistance and goods procurement was delivered to the state to improve governance and effect reform through capacity development and policy/planning assistance in key agencies. The PNG Government budget decomposes foreign aid into four main categories: technical assistance (personnel) (44 per cent), training (13 per cent), procurement for goods and services (35 per cent) and other (8 per cent). The allocation of aid to these categories is determined during the design phase of a program, based on an assessment of state capability gaps.

As a result of the concentration of Australian aid on the state, the dominant area of Australian aid expenditure in PNG is Technical Assistance (TA). Using 2005 estimated budget data (AusAID 2005a)*, TA makes up about 44 per cent of Australian aid to PNG. In order to assess if TA has been effective in PNG it is first useful to examine the assumptions that underpin the relationship between the supply of TA and development outcomes. Aid programs assume that the supply of TA will result in some of the following benefits (Baser and Morgan 2001; Morgan 2002): the transfer of core skills and knowledge from TA to counterparts; improved overall performance of the organisation work practices in an organisation; and actual program delivery, where TA is being provided to substitute for capacity.

Does TA achieve these objectives in PNG? In practice, TA is a mixture of capacity building and capacity substitution whereby the core purpose of the latter is to undertake core tasks to ensure the delivery of services and reform outputs. TA will be most effective where the beneficiary organisation has a mandate for reform, and counterparts are selected on the basis of their own performance and potential to act as a champion of reform. There are some cases where Australian TA has increased the skill, knowledge and competency level of individuals at the middle management level

* This excludes police expenditure under the ECP Treaty which was planned for 2005 but not expended due to aspects of the ECP Treaty being ruled unconstitutional by the PNG Supreme Court, and the subsequent decision by the Australian Government to withdraw police serving under ECP. At the time of writing, the policing package of ECP was still on hold subject to negotiation between Australia and PNG.

and the broader organisation in the PNG public sector. For example, Australian-funded TA to the Ombudsman Commission (OC) in the 1990s, delivered under an independent Ombudsman, was considered to have been influential in strengthening the OC and its effectiveness in undertaking its core integrity system tasks (PNG Ombudsman 2002). On the other hand, there are examples where TA has taken over core tasks and led to displacement, deskilling and disempowerment of Papua New Guineans. For instance, there is a growing awareness that the placement of substantial Australian TA, under the ECP, in PNG's Treasury Department is beginning to have a 'hollowing out' effect on the institution (DNPRD official 2006). In the absence of political will, supply-driven TA to fill performance gaps cannot shape political will or replace the public sector's role in managing staff performance.

In many cases, TA is linked to goods and services associated with the delivery of projects and sector-wide approaches. Australia's high proportion of TA is illustrative of the high transaction costs of weak government and the opportunity cost of Australia not being able to provide aid through PNG's system, using its government resources. On the whole, there is little evidence to suggest that expenditure on TA has been successful in shifting the incentive structures within aid beneficiaries. Although the stated aim of TA has been capacity building, in many cases TA has in fact compensated for poor state performance and taken on responsibility for some core state functions. For example, through the Commodity Assistance Support Project Australia funded and delivered almost 100 per cent of state supplied school materials for elementary and primary schools across PNG.

The second category of aid is the delivery of training, comprising about 13 per cent of Australian aid flows in 2005 (AusAID 2005a). Training programs assume that these individuals will act as change agents within their organisations and communities by enhancing the knowledge and skill set of individuals. Similar to our previous deliberations on TA, training as a catalyst for change relies on a critical mass of trained individuals to occupy positions where they can not only influence change, but

also have a willingness to do so. It also relies on training recipients operating within an institutional environment where they can exercise these skills, and where management demands higher performance as a result of the training. In general, this is not the case in PNG. To date, there is some evidence that Papua New Guineans who have taken tertiary studies overseas have often been agents of change. For example, the PNG Treasurer, a scholarship beneficiary, is considered to be a significant reform agent and the *Kumul Foundation*, a network association that emanated from PNG students in Australia, is undertaking important work on leadership and ethics. However, the Director of the *Kumul Foundation* estimates that less than 5 per cent of scholarship holders have returned to PNG and sought to undertake a catalytic leadership role (Smare 2006). Anecdotal evidence suggests this development activity is just as much about exposure to external ideas and systems as the skills and knowledge acquired through training.

The third category of Australian aid is financial support for core service delivery. From 2005 data, this expenditure category makes up about 35 per cent of Australia aid (AusAID 2005a). The assumption underpinning aid funding for service delivery in health, education, transport infrastructure and law and justice is to complement government agencies to improve the livelihoods of Papua New Guineans throughout the country. Funding for services can only shift incentives in key service delivery agencies to the extent that aid resources are performance-based. Australian aid has sought to support service delivery in the health sector and for road maintenance by using sectoral approaches, with PNG agency performance elements. However, on the whole, Australian aid has often been fungible, and had not been well-positioned in the 1980s and 1990s to influence PNG's allocation of resources. Funding for service delivery will only act as an incentive at the macroeconomic level if it is provided on a performance basis, i.e. Australian aid is provided on the basis of a formula related to PNG expenditure on goods and services, excluding salaries. Under the revised aid arrangements currently being renegotiated between PNG and Australia, a tighter

performance management system incorporating some of these features has been agreed 'in-principle' (Governments of PNG and Australia 2005:4-5).

The remaining 8 per cent of Australian aid covers expenditures that do not clearly fit into any one of the categories outlined above (AusAID 2005a). A significant amount of this funding is for community-level development.

In essence, Australian aid in PNG primarily follows a *functional-push approach*, whereby interventions are directed at strengthening formal organisational structures, systems and skills transfer. In reality only a small amount of Australian aid interventions seek to employ *political-push* and *pull* approaches by adopting incentive-based approaches. Bolger, Mandie-Filer and Hauck (2005:24) studied the PNG health sector and suggested that if aid interventions aim to provide an impetus for endogenous change, then interventions need to be practical, and linked to what matters to the everyday lives of Papua New Guineans. Furthermore, this study found that formal approaches to capacity development, which have dominated Australia's approach as outlined above, do not sufficiently consider the need for the development of 'soft capacities', such as attitudes, values motivations, that influence behaviour.

In sum, it can be concluded that it is almost impossible for aid to induce change where it has been premised on a functional-push approach, with insufficient attention to political-push and pull strategies that explicitly aim to shift incentive structures incrementally. However, it is recognised that Australia is seeking to shift this imbalance by refocusing its aid interventions at the sub-national level of government and through increasing its attention on capacity development of non-state actors, and the relationship between the state and civil society (AusAID 2005b; Fox, Kini and Stephens 2005). For instance, the new aid arrangements under the *PNG/Australia Country Strategy Framework* provide for a AUD30 million performance grant, which may increase over time subject to good performance. Until now, the Australian aid program has been fixed at AUD300 million per annum and delivered in PNG

regardless of the PNG Government's performance. These changes are moves in the right direction.

Demand-Side Conditions of Aid Interventions

We now consider the demand conditions *within* PNG that provide the context for Australian aid interventions in PNG. In general, there is limited effective pressure on the PNG state to minimise government failure. This stems from the underdevelopment of the economy, formal political structures and the transition of PNG society from traditional to modern systems, and a resultant confused understanding of the role of the PNG state. Indeed, most civil society pressure arises from demand for localised services and projects, such as an adequate water supply, and is directed at elected representatives. However, there is weak effective civil society demand for improving state capacity through broader economic and institutional reforms.

This translates to an environment that is not yet conducive to undertaking the institutional change being supported by functional-push aid interventions. For example, in 2005 Australia budgeted to spend AUD50 million in the PNG health sector on TA and goods/services funding premised on the need for continued reform. This mandate has been set by the donor program, and is not based on domestic political and civil society pressure to improve health outcomes. Because of these domestic demand conditions, aid interventions - particularly where functional-push approaches are employed - are subject to high rates of organisational failure.

Foreign aid can help to shape domestic demand by increasing information and reducing power asymmetries. These changes can be effected through the provision of aid to support the media sector, community participation in sector program, participatory community development projects, and economic interventions such as micro-finance and road maintenance. Performance-based aid that seeks to influence

institutional incentives may also generate internal reform if appropriately implemented and enforced.

Two key points are relevant for future aid frameworks in PNG. First, donors in PNG have to shift their focus away from the supply of functional-push aid targeted at state capacity building when there is not an effective domestic constituency for reform and limited political ownership. Donors can, and should, continue to improve the quality of functional-push aid interventions, but understand it may have limited effects on long-term development outcomes unless aid is actively helping to address non-market failures, in particular through helping to shape the demand conditions discussed earlier. This means pursuing aid interventions that enhance social cohesion and collective action, to help civil society ‘rebalance’ its power relations with those that capture the resources of the state. For example, at the national level it might mean providing core funding for groups to evaluate and publish PNG Government expenditure. At the provincial level it might be greater expenditure on rural roads to increase economic activity and information-based interventions around local service delivery. An example is encouraging parents associations to form, on a voluntary basis, around schools to promote the transparent use of school resources. This latter type of aid program interventions are overtly political because they challenge and monitor political and bureaucratic resource allocation decisions.

Second, this analysis raises questions about the assumptions the PNG aid literature reviews have made about the relationship between aid and state fragility. The fragile state paradigm, implicit in the formal reviews of PNG aid effectiveness examined earlier, is based on the premise that aid is necessary to improve sectoral outcomes and to prevent the collapse of services. An alternative view is that Papua New Guineans will begin to mobilise themselves to demand better governance when services collapse completely. However, this hypothesis does not hold true for many areas in PNG where governance has already deteriorated to the point that the state is delivering few goods and services. For example, the absence of the state has not led

to effective pressure on government in remote parts of Southern Highlands and Gulf provinces. In part, the fact that other organisations, such as NGOs, the Australian-funded Community Development Scheme, the churches and resource companies, have filled the gap has alleviated public pressure on the government to deliver services in these areas (Kini 2005).

Aid Accountability

In PNG, the political principal-agent problem encapsulated in the formal system lies at the core of political dysfunctionality. Put differently, political representatives who make decisions about resource distribution are generally not making these decisions in the interests of the electorate they purport to represent. This occurs at the national level and all the way down to the clan level. Figure 2 below illustrates a number of accountability relations that exist in the formal system.

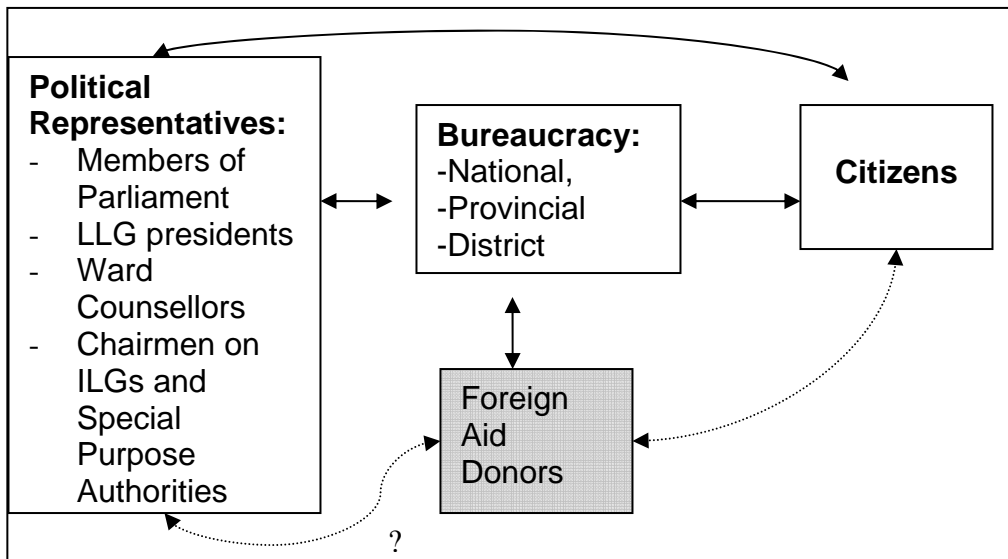


Figure 2: Principal-Agent Relationships in Formal System

Where external interventions, such as Australian aid, make up a considerable component of government expenditure, it raises questions about where donors find themselves in the accountability function. Donors are both principals and agents.

They are accountable to the PNG Government in terms of delivery of aid within agreed PNG Government policies and priorities, and can demand certain governance requirements to be met as a condition of continued aid as well as a safeguard against moral hazard. Global studies have found that ownership of reform is weakest where the reform package has been donor initiated, lacking in domestic demand and designed with limited local input. If aid programs have these characteristics, cross-country analysis has shown that implementation is weak and likely to fail (Killick 1998:87-100).

In most cases, donors have choices about whether they provide aid to a state. However, in the case of PNG, former colonial ties and strategic interests in a stable PNG state have left the Australian government with comparatively little choice about providing aid. The PNG government is thus confidently aware that the provision of Australian aid to ensure the stability of the state will continue. In this sense accountability of the PNG state to Australia is extremely weak, given the likelihood that Australia will continue to provide high levels of aid to PNG, regardless of its performance. Moreover, history has shown that poor performance has not led to less aid. Accordingly, at the macro-level Australian aid does not provide an incentive for the political leadership to improve its governance. The failure of aid to act as a lever of change because of non-enforcement of the contract between the principal (donor) and the agent (recipient government) is well-documented on a global basis (see Killick 1998).

Under the recently negotiated *PNG/Australia Country Strategy Framework*, Australia sought greater engagement with PNG on expenditure of their revenues as a condition of financial support. In this sense, Australia seeks greater accountability from the PNG Government to compensate for the weakness of state and a lack of collective action for accountability from citizens. This may have some impact in shifting incentives at the macro level, but only if the performance framework is appropriately structured, and has ownership within PNG. By ownership, it is implied that there is

an awareness, participation and political commitment to the package. The Australian government must have the conviction to enforce the performance framework and secure the agreement of the PNG government to close the large information asymmetries about how PNG actually expends resources to have any hope in Australian aid acting as a lever for change.

It is not clear what role Australian aid plays in either enhancing or severing accountability links between political representatives and citizens. It could be argued that Australian aid is contributing to weakening organic institutional development by seeking to take on responsibility for holding the PNG Government to account, and reducing the need for Papua New Guineans to take action. In developing the new arrangements, it is thus critical that the transparency of aid resource allocations, linked to the PNG budget, are well understood by civil society.

Implications for Australia's PNG Aid Strategy

It has been argued that Australian aid has had both positive and negative influences on institutional change and economic development in PNG. The impact of Australian aid, as well as suggestions for improving aid performance in future, can be evaluated under three main categories: the focus of Australian aid; the coherence of Australian aid; and Australian aid and civil society.

In the first place, in terms of its main focus, Australian aid has assumed that PNG's governance problems will be eased by targeting assistance at the state. Accordingly, its first major limitation is that aid has been overly state-focused, at the expense of broader societal development. With about 93 per cent of Australian aid delivered through the state, there is limited effective competition for funds because aid has been distributed on the basis of supporting the necessary core functions of government, such as health, education, transport infrastructure, macroeconomic stability, and law and justice. Since there has been a strong expectation on Australia to support core

functions, no effective competition has emerged between agencies on the basis of demonstrated reform. This reliable level of aid funding for service delivery has reduced the pressure to undertake public sector reform and exercise fiscal discipline. For example, following expenditure ‘blowouts’ related to the 2002 national election, as the PNG Government had run out of funds to meet its core commitments.

A second feature of the focus of Australian aid is that it has operated on the assumption of ‘trickle-down’, with around 89 per cent of directly supporting national expenditure responsibilities (NEFC 2005) and primarily delivered through national institutions. Often national institutions, which are the primary negotiators of aid, have targeted assistance for their own needs. For example, in the education sector, about 94 per cent of funding has supported national functions (NEFC 2005). Provincial and local level governments have historically only benefited through goods and services flowing from the national level. Aid benefits to the sub-national level have mostly been delivered in the form of training courses and materials outside of their own budget (i.e. not equivalent or fungible for cash or other priorities). Australia’s new Sub-National Initiative (SNI) which directs a small percentage of aid expenditure to directly support reform through province’s own budget framework in three pilot provinces, is a move in the right direction.

A third notable aspect of the focus of Australian aid is that it has followed a functional-push approach as we argued earlier. Nevertheless, it is worth further discussing the Australia Government decision in 2003 to deliver additional TA to PNG through ECP. Although the ECP was supported by a number of key reformers in PNG, it has generally been conceived of as an Australian and not PNG owned and designed initiative (Sugden 2004:61). It appears to have been developed as a response to an Australian fear of continuing deterioration in PNG’s governance (Dinnen 2004), rather than in response to a PNG domestic push. Mekere Morauta (2004:4), former Prime Minister of PNG, made the comment that ‘the glue cannot be manufactured by Dick Smith; it must be Made in Waigani’. Sugden (2004:62-63) points out that ECP

is technical in nature, similar to many past aid interventions, and does not ultimately modify the institutional environment. He has concluded that ECP offers a temporary relief to symptoms within key state institutions, but does not tackle the root of governance problems in PNG (Sugden 2004:55). The success or otherwise of ECP, and other TA, can only really be assessed over the medium to long term. Only if ECP can make a difference in minimising corruption on a systemic basis and helping the state to successfully prosecute leaders, which eventually acts as a disincentive for leaders to undertake corrupt practices, is it likely to be judged a success (see Morauta 2004:54).

Fourth, the majority of the 7 per cent of Australian funding delivered through non-state actors, such as the church and non-government organisations, has primarily been focused on delivering services in place of government. Only a small percentage of total aid flows have been used to influence domestic demand by strengthening the capacity of civil society to advocate for a more effective government. Direct capacity focused and core funding assistance to civil society organisations in 2004 and 2005 totaled about K5.2 million (Community Development Scheme II 2005).

Finally, all aid to PNG has raised both the costs of government and the expectations of public servants who benefit from aid. For example, in the 1990s the PNG Government adopted the UN rates of \$US300 a day for overseas travel by civil servants on aid-funded business. It has also contributed to the rent-seeking culture of government by providing new cars and materials alongside projects that should ordinarily be a lower priority for government expenditure. Where aid activities have delivered 'cargo', such as international travel, they can divert the state's resources away from their core business. For instance, the senior planning officer in a Provincial Government spent from six to twelve months of 2004 on various funded short-term missions and courses funded by the Japanese Government and the UN.

The second generic category useful for assessing the impact of Australian aid is aid coherence. Together with other aid to PNG, Australia aid has been unsuccessful at positioning aid inflows to influence performance within central agencies. In recent years there were attempts by AusAID, the ADB and the WB to reconsider aid collectively through a Joint Country Strategy process. However, the PNG Government perceived this process as donors ‘ganging up’ and requested it to be halted. At the central level, aid has lacked coherence and potential for leverage. The absence of a jointly agreed strategy and procedures also means all donor programs operate under different systems and philosophies. Some donors, such as Australia and New Zealand, provide program-based funding where priorities for funding are mainly set with government. Others, like Japan, deliver all aid ‘in-kind’. The EU delivers most of its funding through government contracts. These different systems create confusion amongst PNG government officials and citizens. There is thus an urgent need for better coordination and harmonisation of donor approaches and procedures. Some progress to address poor coordination is now being made at the sector level. The health sector is the best example where this approach has been reasonably successful. The education sector stands at the opposite end, where there are over twenty separate donor-funded projects, and in some cases donor policy objectives even pull in opposite directions. For instance, Australia is pursuing an ‘affordable’ approach to education and UNICEF is pushing ‘free education’.

The final category subsumes aid and civil society. Australian aid to date has not had sufficient focus on influencing the effectiveness of the political system from the national level down to the ‘grass-roots’ level. Coupled with economic development, it is possible over the long term that donors can work with reform agents to reduce public expenditure information deficiencies about public expenditure, thereby enhancing effective public demand for improved government performance. Australian support to PNG’s National Economic and Fiscal Commission (NEFC) to undertake analysis and dissemination of information about resource distribution may help shape and heighten public awareness if it is accessible and meaningful to enough

people. Australia's recently formed partnerships with the Media Council and the National Broadcasting Commission aim to increase public information flows and debate. The new aid arrangements, which will require the PNG Government to be more transparent about its expenditure, may help shape demand for better political decision making if sufficient public awareness exists to ensure Papua New Guineans outside government understand the terms and conditions of aid. However, under a tighter performance framework, it seems likely that aid will only be effective in leveraging resource allocation decisions within agencies where aid funding is significant relative to other possible sources of rents (such as resource rents).

Concluding Remarks

By way of conclusion, a final caveat should be added to the fairly damning assessment of Australian aid at the macro-level presented in this paper. It must be stressed that our analysis is not intended to suggest that all individual Australian aid programs have not provided a foundation for change in PNG at the level at which they have operated. Indeed, there are some positive examples of how Australian aid has encouraged reform within sectors, provinces, and individual organisations. Nonetheless, much remains to be done if Australian aid is to have a beneficial rather than a malign impact on PNG.

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