

CHAPTER 5. DEVELOPMENT STRATEGY

5.1 OVERVIEW

5.1.1 Introduction

The MTDS identifies seven Expenditure Priority Areas (EPAs) in which Government focuses its investments to meet people's basic needs and enable Papua New Guinea to make tangible progress in terms of its economic and social development. The seven EPAs are:

1. Primary and Preventive Health
2. HIV/AIDS Prevention
3. Basic Education
4. Development Oriented Adult Education
5. Transport Rehabilitation and Maintenance
6. Promotion of Income Earning Opportunities
7. Law and Justice

5.1.2 Aligning the Development Budget with the MTDS

The effective implementation of the MTDS requires that the proportion of the Budget allocated to MTDS EPAs increases every year. A medium term target has been set to increase MTDS alignment of all GoPNG expenditure – direct financing, tax credit and loans – from 48 per cent in 2005 to 55 per cent by 2010. For 2007, the Budget Strategy sets a target of no less than 52 per cent. It is also expected that the proportion of the Development Budget funded by Government moves towards 100 per cent MTDS alignment over the medium term. For 2007, the Budget Strategy sets a target of no less than 84 per cent.

The need to align the Budget with MTDS EPAs is encouraged in 2007 with the introduction of the AusAID Performance Grant. The Performance Grant is a new funding facility, valued at AUD\$30 million (approximately K70 million) in 2007 and will be used to scale up development interventions in line with MTDS EPAs. Receipt of the Performance Grant is conditional on Government meeting certain triggers, as agreed in the Australia-Papua New Guinea Development Cooperation Strategy 2006-2010. Among the triggers is the achievement of the Budget Strategy targets on the degree of MTDS budget alignment in the 2007 Budget. The Government recognizes that failure to meet this condition would result not only in the full performance grant being foregone, but would also give a poor reflection of its commitment to good governance, which the Performance Grant triggers are intended to support.

5.2 DEVELOPMENT EXPENDITURE CONSIDERATIONS

For 2007, the Government has developed a more strategic approach to its expenditure decisions in the Development Budget by examining how its limited resource envelope should be best spread across the seven EPAs. This approach is structured around answers to the following two questions:

1. What does the Government believe to be the appropriate balance of total development expenditure (both Government and development partners) across the different EPAs?; and
2. What relationship does the Government wish to form between its spending and that of development partners?

5.2.1 Balancing Spending Across the Expenditure Priority Areas

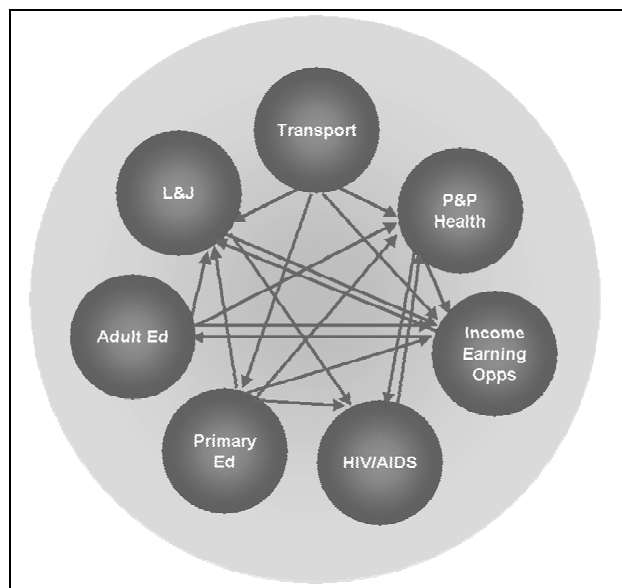
Up until the 2007 Development Budget, prioritization among the EPAs has been limited to the Transport Rehabilitation and Maintenance. This prioritization, though limited, has been well-judged according to public opinion. However, if further ground is to be made in improving the coherence and effectiveness of development expenditure, a new approach to prioritization is required.

The Government's new approach to prioritization has been to look at how sequencing can be used to guide patterns of expenditure. Three sequencing considerations are described as follows:

Ordering expenditure with regard to how expenditure in one area influences performance in other areas.

The impact of investment need not be restricted to a single sector. Investment can trigger a multi-faceted response across different aspects of social and economic development. For instance, expenditure on Transport Maintenance and Rehabilitation will enhance the Promotion of Income Earning Opportunities by reducing transport costs, as well as increasing the impact of economic sector programmes. On this basis, it would be most efficient to prioritize spending in those EPAs that have the greatest effect on other EPAs, namely, Transport Maintenance and Rehabilitation and Primary Education, as depicted in Figure 17.

Figure 17: Interdependence of Sector Spending



Source: Department of National Planning and Monitoring

Ordering expenditure with regard to differences in the lag between expenditure and outcomes.

The returns to investment can differ in terms of the lag before those returns accrue. For instance, the greatest impact of Basic Education expenditure on economic growth might take 20-30 years to take effect. To achieve results in all its priority areas, the Government must begin investing early in those areas where investments take longest to have their effect. On

this basis, it would be most efficient to prioritize spending in Basic Education and Law and Justice as these have the longest lag in realizing the intended outcomes.

Ordering expenditure with regard to the cost of expenditure today versus tomorrow.

The nature and scope of development issues are bound to change over time and the cost of tackling such issues will rise or fall accordingly. For instance, expenditure today on HIV/AIDS Prevention would prevent the need for expenditure tomorrow on HIV/AIDS treatment, which would come at a much greater cost to the Government, let alone to the economy and Papua New Guinea's diverse communities. It would be prudent to spend in such a way as to minimise its future costs. On this basis, it would be most efficient to prioritize spending in HIV/AIDS Prevention, followed by Law and Justice and then by Transport Rehabilitation and Maintenance.

The three sequencing considerations above lead to the following revised priority order for the 2007 Development Budget:

Transport Rehabilitation and Maintenance
 Basic Education, Law and Justice, HIV/AIDS Prevention
 Primary and Preventative Health
 Development Oriented Adult Education, Promotion of Income Earning Opportunities

5.2.2 Balancing Government and Donor Expenditure

Building on the 2006 Budget, the Government has been working steadily towards establishing a clear relationship between its funding and development partners' contribution towards the budget. This is to avoid arbitrary funding arrangements that existed when Government was limited to a peripheral funding role in some EPAs, relaying ambiguous signals to both civil society and development partners. The ambiguity in the relationship meant that some development partners focused spending in their preferred areas.

For the 2007 Development Budget, the Government has adopted a Matching Funds Strategy in which it allocates its own expenditure to the EPAs in line with its preferred expenditure share. Development partners are encouraged to imitate the Government's expenditure pattern thereby scaling up the level of expenditure while reinforcing the share across the different priority areas.

The Matching Funds Strategy maximizes the alignment of different funding parties, thereby enabling a greater partnership and increasing the likelihood of the optimal expenditure share of spending across the EPAs. The Government's 2007 development expenditure pattern provides a clear signal to development partners, enabling the Government to show leadership in determining patterns of development expenditure whilst illustrating to civil society that the Government is serious about funding its own priorities.

5.3 THE MEDIUM TERM RESOURCE FRAMEWORK (MTRF)

The Sequencing and Matching Funds Strategy have informed the Government's expenditure decisions in the 2007 Development Budget, through the compilation and application of a set of indicative sector ceilings. These ceilings were generated through the Medium Term Resource Framework (MTRF), which provides estimates as to the likely direction of expenditure – both recurrent and development, Government and development partners over a three year period. The MTRF takes into account all existing funding commitments, including existing development projects and programs; the size of the total resource envelope as estimated in the Medium Term Fiscal Strategy (MTFS) and updated in the

Budget Strategy Paper; and the expected degree of the Budget's MTDS-alignment, in line with Government's development agenda.

5.4 DEVELOPMENT BUDGET 2007

Table 47 illustrates the summary data for the 2007 Development Budget. Of a total Development Budget of K1,636.6 million, K757.5 million originates from Government sources, whilst K879.1 million is contributed by development partners. K1,182.3 million of the total Development Budget is directly targeted at the seven MTDS EPAs.

Table 47: 2007 Development Expenditure (Kina Millions)

	2007 GoPNG	2007 Grants	2007 Total
MTDS Expenditure Priority Areas	563.8	618.5	1,182.3
Other	193.7	260.6	454.3
TOTAL	757.5	879.1	1,636.6

Source: Department of National Planning and Monitoring

The Government's contribution to the Development Budget comes in three forms: direct financing, Tax Credit Scheme and loans. The Tax Credit Scheme and loans are predominantly used for Transport Maintenance and Rehabilitation whereas the Government's direct financing is targeted at each of the seven EPAs.

Table 48: 2007 GoPNG Development Expenditure on MTDS Priority Areas (Kina Millions)

	Direct Financing	Tax Credit	Loans	Total GoPNG
Primary and Preventive Health	45.0	0.0	3.0	48.0
HIV/AIDS Prevention	12.5	0.0	0.0	12.5
Basic Education	26.9	0.0	0.0	26.9
Dev-Oriented Adult Education	3.5	0.0	5.1	8.6
Transport Rehab and Maintenance	159.8	85.4	132.3	377.5
Income Earning Opportunities	51.5	0.0	8.2	59.8
Law and Justice	30.5	0.0	0.0	30.5
Sub-Total	329.8	85.4	148.6	563.8
Other	179.3	0.0	14.4	193.7
TOTAL	509.1	85.4	163.0	757.5

Source: Department of National Planning and Monitoring

Due to a higher degree of MTDS alignment in its expenditure, a larger direct financing component and a more equitable share across the EPAs, the contribution of GoPNG's direct financing has been scaled up in six of the seven EPAs in 2007, compared to the 2006 Development Budget. The most notable increases in absolute terms are in Primary and Preventative Health (up K17 million), Law and Justice (up K14 million) and Basic Education (up K12 million) whilst in percentage terms, the largest increases are in HIV/AIDS prevention (318 per cent) and Development Oriented Adult Education (up 168 per cent).

Whilst Government's direct financing has fallen in the area of Transport Rehabilitation and Maintenance, it should be noted that this decrease is more than outweighed by a shift in the use of Government loans focusing almost exclusively on this EPA for the first time. Total

Government expenditure in this priority remains very high, both historically and relative to appropriations to other sectors.

Table 49: 2007 versus 2006 GoPNG Development Expenditure Direct Financing on MTDS Priority Areas (Kina Millions)

	2006 GoPNG	2007 GoPNG	Change	Change Per cent
Primary and Preventive Health	27.8	45.0	17.2	62.0
HIV/AIDS Prevention	3.0	12.5	9.5	318.1
Basic Education	14.4	26.9	12.5	86.8
Dev-Oriented Adult Education	1.3	3.5	2.2	168.3
Transport Rehab and Maintenance	170.1	159.8	-10.3	-6.1
Income Earning Opportunities	43.5	51.5	8.0	18.4
Law and Justice	15.9	30.5	14.6	91.8
Sub-Total	276.0	329.8	53.8	19.5
Other	183.0	179.3	-3.8	-2.1
TOTAL	459.1	509.1	50.0	10.9

Source: Department of National Planning and Monitoring

The majority of the Government's expenditure outside of the EPAs is for constitutional grants (District Support Grants) and development grants (Special Support Grants (SSGs), Memorandum of Agreements (MoAs) and the Bougainville Peace Agreement. Appropriations for development grants are particularly high in 2007 due to buoyant production levels across Papua New Guinea's extractive industries increasing the value of SSGs and a more disciplined approach by the Government to budget for its MoA commitments. It is estimated that the majority of both constitutional and development grants are ultimately expended on MTDS aligned projects and initiatives.

Table 50: 2007 GoPNG Development Expenditure Outside of MTDS Priority Areas (Kina Millions)

	Direct Financing	Tax Credit	Loans	Total GoPNG
Governance Reform	6.7	0.0	9.4	16.1
General Government Administration	2.3	0.0	0.0	2.3
Aid Administration	0.2	0.0	0.0	0.2
Constitutional Grants	54.5	0.0	0.0	54.5
Development Grants	97.3	0.0	0.0	97.3
Other Government Services	18.3	0.0	5.0	23.3
TOTAL	179.3	0.0	14.4	193.7

Source: Department of National Planning and Monitoring

The MTRF has also resulted in a more balanced share of development expenditure by Government and development partners across each of the EPAs. The high ratios in favour of development partners for HIV/AIDS Prevention, Basic Education and Law and Justice have all now been tipped closer towards balance, with the Government assuming greater responsibility for these priorities.

Table 51: 2007 GoPNG Development Expenditure Versus Donor Expenditure (Kina Millions)

	2007 GoPNG Development	2007 Donor Grants	2006 Ratio	2007 Ratio
Primary and Preventive Health	46.2	95.1	1:2	1:2
HIV/AIDS Prevention	12.5	96.4	1:14	1:8
Basic Education	26.9	74.4	1:7	1:3
Dev-Oriented Adult Education	8.3	2.9	1:1	4:1
Transport Rehab and Maintenance	375.5	185.9	2:1	2:1
Income Earning Opportunities	58.4	67.8	1:1.5	1:1
Law and Justice	30.5	62.6	1:5	1:2
TOTAL/AVERAGE	558.3	585.0	1:1.5	1:1

Source: Department of National Planning and Monitoring

When all Government expenditure is taken into account, the Government is the lead financier in six out of the seven EPAs. It is envisaged that the trend towards greater Government leadership in terms of financing will coincide with the Government taking greater responsibility for service delivery in each of these priority areas.

Table 52: 2007 GoPNG Total Expenditure Versus Donor Expenditure (Kina Millions)

	2007 GoPNG Recurrent & Development	2007 Donor Grants	2006 Ratio	2007 Ratio
Primary and Preventive Health	436.4	95.1	4:1	5:1
HIV/AIDS Prevention	17.3	96.4	1:6	1:5
Basic Education	531.3	74.4	5:1	8:1
Dev-Oriented Adult Education	24.6	2.9	3:1	10:1
Transport Rehab and Maintenance	485.3	185.9	3:1	3:1
Income Earning Opportunities	181.3	67.8	2:1	3:1
Law and Justice	364.5	62.6	3:1	7:1
TOTAL/AVERAGE	2,040.6	585.0	3:1	4:1

Source: Department of National Planning and Monitoring, Department of Treasury

5.5 FUTURE DEVELOPMENT BUDGETS

The Government will continue to use the Medium Term Fiscal Strategy and Medium Term Development Strategy to determine the size and content of the Development Budget in future years.

5.5.1 Developing a Performance Management Framework for the MTDS

Chapter 6 of the MTDS specifies the need for Government to establish a Performance Management Framework (PMF) to monitor implementation of the MTDS. The MTDS PMF will serve as a crucial tool to track and report on the country's development and to determine to what extent Government sponsored interventions are supporting this end. It is only by scrutinizing its own performance that the Government can become more effective in realizing the national development objectives.

In 2000, the Government signed the United Nations Millennium Declaration, thereby committing itself to the attainment of the Millennium Development Goals (MDGs) by

investing in key development areas. For Papua New Guinea the MDGs have been integrated into the MTDS. This means the attainment of the MDGs are considered as evidence of MTDS achievement. It is for this reason that the MDGs play a central role in the design of the PMF. By having in place a set of well-defined goals, the Government can then determine which indicators it must observe in order to track performance in having those goals realized. Tracking the performance of indicators focuses attention on the type and scope of interventions that are likely to deliver outcomes. The integration of the MDGs into the MTDS therefore places greater emphasis towards implementation and outcomes, as opposed to only budgeting and inputs.

To establish the MTDS PMF, the Government will define a sample of quantitative and qualitative indicators that reflect MTDS implementation in each focal area or sector. These indicators will be determined through close collaboration and consultation between relevant Government agencies. It is envisaged that success against these indicators will ultimately be used to influence the budget process, with the Budget Screening Committee incorporating performance assessments in determining allocations to agencies – both recurrent and development.

Development partners have expressed an interest in using the MTDS PMF to judge where their resources can most effectively be channeled and how their interventions are contributing towards the realization of the goals stated in the MTDS. It is expected that the MTDS PMF will be operational in time for the 2008 Budget Cycle.