

## **CHAPTER 6. DEVELOPMENT STRATEGY**

### **6.1 OVERVIEW**

The Medium Term Development Strategy 2005-2010 (MTDS) continues to serve as the Government's overarching plan for the social and economic development of Papua New Guinea (PNG). The MTDS identifies seven Expenditure Priority Areas (EPAs) to guide public expenditure.

The seven EPAs are:

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

The 7 EPAs each share two common features:

- They concern the basic needs of all Papua New Guineans: security, income, mobility, good health and schooling; and
- They require significant and increased financial resources.

It is for these reasons that the 7 EPAs represent the most urgent and fundamental spending priorities of Government.

While the MTDS identifies various other urgent reform agendas facing the country – Public Sector Reform, Public Expenditure Management, Macroeconomic Management, Governance, Environmental Protection, Gender Equality – these do not require significant public expenditure as part of their reform. Instead they require other solutions, such as stronger leadership, better policies and legislative reform.

### **6.2 INFORMING THE BUDGET WITH THE MTDS**

In the 2007 Development Budget, Government developed a more strategic approach to its investment expenditure. This helped deliver a budget that was ultimately more responsive to the MTDS. This same approach is pursued further in the 2008 Budget.

This approach is structured around three policies:

- I. What share of Government's expenditure should be focussed on MTDS priorities;
- II. How expenditure should be spread across the seven EPAs to maximise the development returns; and
- III. What relationship the Government wishes to form between its spending and that of its development partners.

#### **6.2.1 Aligning the Budget with the MTDS**

The effective implementation of the MTDS requires that the proportion of the Budget allocated to the MTDS increases every year. A medium 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 2008, the Budget Strategy sets a target of no less than 53 per cent. A separate target of no less than 88.5 per cent is set for development expenditure alone in 2008.

The achievement of these targets requires Government to eliminate the funding of non-essential expenditure items and switch resources towards its priority areas.

### 6.2.2 Balancing Spending Across the Expenditure Priority Areas

Government endeavours to spread development expenditure across the seven EPAs in accordance with its *Sequencing Principle*. This Principle justifies timing spending to occur in one area prior to that in another, so as to maximise the net development returns, inclusive of all the EPAs. This is consistent with the goal of maximising allocative efficiency.

In practice, the Sequencing Principle means:

- Spending in areas with the greatest *spillover* effects on to other expenditure areas. For example, expenditure in transport rehabilitation supports the promotion of income earning opportunities.
- Spending in areas where there is a long *lag* between expenditure and outcomes. For example, achieving a high level of education throughout the country will take time and therefore requires us to begin investing now.
- Spending in areas to reduce *future cost* to Government and society. For example, promoting HIV/AIDS prevention to avoid the formidable cost associated with a country wide pandemic.

Incorporating each of the three sequencing considerations above generates a revised order for prioritising development expenditure over the 7 EPAs:

- 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

This applies to both GoPNG and donor expenditure.

### 6.2.3 Balancing Government and Donor Expenditure

Government endeavours to balance its expenditure with that of its development partners in accordance with its *Matching Funds Principle*. This Principle sees Government allocate its own expenditure to the EPAs in line with its preferred expenditure share. Development partners are then encouraged to imitate the Government's expenditure pattern, thereby scaling up the level of expenditure while reinforcing the share across the different EPAs.

The Matching Funds Principle maximizes the alignment of different funding parties, thereby enabling greater partnership and increasing the likelihood of total expenditure being spread optimally across the EPAs. Through this Principle, Government's own spending preferences provide a clear, unambiguous 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. Government can therefore avoid the arbitrary funding arrangements which existed in the past, when Government limited itself to a peripheral funding role for some EPAs and left development partners to focus spending in their preferred areas.

### 6.3 THE MEDIUM TERM RESOURCE FRAMEWORK (MTRF)

The above three policies are used to inform Government and donors' expenditure decisions through the Medium Term Resource Framework (MTRF). The MTRF is a three-year expenditure planning tool for the MTDS. It assists GoPNG in achieving and managing an increased allocation of development expenditure towards the country's greatest priority needs by modelling the shape of future annual budgets and generating parameters which guide how appropriations can best be used.

The MTRF produces two important outputs:

- I. *Funding Gaps*, which provide a guide for the use of unallocated expenditure, based on a comparison of known future commitments to each EPA and the optimal affordable allocation to that EPA. These funding gaps refer to the total resource envelope – both GoPNG and donor – indicating the level of development expenditure that can be harnessed if GoPNG effectively coordinates all available funding. These funding gaps can assist donor expenditure planning (including the negotiation of new Country Strategies), improve coordination between different funding parties and serve as an early warning system for funding shortfalls. Calculations of the Funding Gaps for 2009 are provided in the table below.

**Table 48: 2009 Funding Gaps (Kina Millions)**

	Expenditure Commitments	Optimal Allocation	Funding Gaps
Primary and Preventive Health	158.9	194.9	36.1
HIV/AIDS Prevention	71.9	143.3	71.5
Basic Education	89.9	172.0	82.1
Development Oriented Adult Education	2.0	14.3	12.4
Transport Rehabilitation and Maintenance	448.2	614.9	166.8
Income Earning Opportunities	41.5	111.8	70.4
Law and Justice	92.0	182.0	90.1

Source: Department of National Planning and Monitoring

- II. *Indicative Sector Ceilings*, which set parameters for the optimal allocation of GoPNG's direct financing component of the Development Budget. Adherence to these parameters ensures that GoPNG meets its own target for the alignment of the Development Budget with the MTDS. Furthermore, the application of these ceilings provides a deliberate and rational shape to GoPNG spending patterns, avoiding a situation where individual items are deliberately funded but the overall picture is accidental or certain priority areas are neglected. Indicative Sector Ceilings for 2008 and 2009 are provided in the table 49.

**Table 49: 2008 & 2009 Indicative Sector Ceilings (Kina Millions)**

	2007 Budget Appropriations	2008 Indicative Sector Ceilings	2009 Draft Indicative Sector Ceilings
Primary and Preventive Health	45.0	33.8	36.8
HIV/AIDS Prevention	12.5	30.9	40.8
Basic Education	26.9	25.3	41.3
Development Oriented Adult Education	3.5	7.3	5.9
Transport Rehabilitation and Maintenance	159.8	156.3	143.1
Income Earning Opportunities	51.5	38.6	51.4
Law and Justice	30.5	46.9	45.9
Governance Reform	6.7	6.3	1.8
General Government Administration	2.3	2.1	0.6
Aid Administration	0.2	0.2	0.1
Constitutional Grants	54.5	54.5	54.5
Development Grants	97.3	97.3	97.3
Other Government Services	18.3	17.2	5.0
<b>Total</b>	<b>509.1</b>	<b>516.7</b>	<b>524.5</b>

Source: Department of National Planning and Monitoring

The MTRF and its two outputs already play a valuable role in enhancing the quality of Development Budget appropriations. Over time, efforts will be made to further integrate the central expenditure planning systems of the recurrent and development Budget to enable key service delivery agencies to better plan their sector expenditure.

## **6.4 PERFORMANCE MANAGEMENT FRAMEWORK**

### **6.4.1 Introduction**

Over the past 12 months, the Government has developed a Performance Management Framework (PMF) to monitor implementation of the MTDS. The MTDS PMF is a tool intended to track the country's rate of development and to determine the contribution of Government towards this end.

The MTDS PMF examines development in each of 13 MTDS PMF sectors:

- Primary and Preventative Health
- HIV/AIDS Prevention
- Basic Education
- Development Oriented Adult Informal Education
- Transport Infrastructure Rehabilitation and Maintenance
- Income Earning Opportunities
- Law and Justice
- Gender
- Environment
- Governance
- Public Sector Reform
- Public Expenditure Management
- Macroeconomic Management

For each sector, Government have identified a small selection of key performance indicators. Tracking the performance of these indicators focuses attention on the type and scope of interventions that can deliver change and the desired outcomes.

The MTDS PMF has two main outputs:

- I. A *Database* which contains each of the key performance indicators; and
- II. An annual report, or *Pocketbook*, which reports and interprets the performance of those indicators and assesses broader trends emerging from the data.

Beyond its value as a tool to determine the pace of development in PNG, the MTDS PMF is also intended to inform Budget decisions, by presenting policymakers with insight into the performance of key result areas and the need for remedial action in areas which are underperforming. Copies of the Pocketbook have therefore been made available to all decision-makers involved in scrutinising the Budget during its formulation.

Copies of the MTDS PMF Pocketbook will also be made available to a wider audience, including civil society. Development partners have expressed an interest in using the MTDS PMF to judge where their resources can most effectively be channelled and how their interventions are contributing towards the realization of the goals stated in the MTDS.

#### 6.4.2 Results of the MTDS PMF

In the Pocketbook, the 13 MTDS PMF sectors are each awarded two overall grades, based on whether their indicators are improving or deteriorating. The first grade - the Trend - assesses indicators' performance over the full series of data from 2000 to present. The second grade - Latest Performance - assesses performance on the basis of the most recently observed data for each indicator. A positive score (between 1 and 5) indicates that development is taking place, with the majority of sector indicators showing signs of improvement. A negative score (between -1 and -5) indicates that the sector is in decline, with more signs of deterioration than improvement.

The illustrated scorecard provides the sector assessments for each of the 13 MTDS PMF sectors. Performance is mixed with some sectors showing consistent improvement (Macroeconomy, Public Expenditure Management) while others show evidence of decline (Governance). Some sectors have experienced a recent

turnaround in performance (Health, Transport, Gender) whereas in others, progress appears to have stalled (Public Sector Reform). The Trend assessment judges that, on aggregate, there has been no discernible development since the year 2000. The improvements that have occurred can be weighed up against a worsening performance in an equal number of areas. In contrast, the Latest Performance assessment reveals that, on the latest evidence, most sectors are now beginning to improve their performance. It is hoped that this positive finding will be reinforced by evidence of further improvement in next year's review.

MTDS PMF Sector	Trend	Latest Performance
Primary and Preventative Health	-2	2
HIV/AIDS Prevention	0	0
Basic Education	1	1
Development Oriented Adult Education	-3	3
Transport Maintenance and Rehabilitation	0	2
Income Earning Opportunities	1	0
Law and Justice	-2	-1
Gender	0	2
Environment	1	0
Macroeconomy	4	5
Governance	-3	-1
Public Expenditure Management	2	3
Public Sector Reform	1	-1
<b>Average</b>	<b>0</b>	<b>1</b>

## **6.5 FUTURE DEVELOPMENT BUDGETS**

The Government will continue to rely on the MTDS and its associated policies to guide its development expenditure over the coming years. In addition, the findings of the MTDS PMF have drawn attention to some of the major challenges which remain if the MTDS is to be effectively implemented:

### **6.5.1 Revitalising essential mechanisms for service delivery**

Key service delivery sectors rely on the functioning of various mechanisms or systems which underpin their performance. For instance, in the health sector, some of these mechanisms include:

- Using sector human resource assessments to determine the recruitment of new healthcare professionals
- Using sector human resource assessments to determine the allocation of personnel to health centres
- The organisation of medical officer visits to health centres
- The supply of drugs to health centres
- The conducting of outreach clinics
- The collection and reporting of health centre data

In sectors which present significant logistical and managerial challenges, such as health, the importance of having effective mechanisms in place cannot be overstated. However, in most sectors, once reliable mechanisms have either stopped functioning effectively or have been rendered inadequate over time. Revitalising simple but effective mechanisms is a crucial part of turning around the performance of struggling service delivery sectors.

### **6.5.2 Reforming Government's approach to maintenance**

One such mechanism which requires significant reform is Government's approach to infrastructure maintenance. Traditionally, maintenance budgets have been too small to finance necessary works. Where funds have been appropriated, these have easily been diverted for alternative, more immediate needs. These failures demonstrate a more fundamental failure in the approach to maintenance: the value of routine maintenance is not always immediately apparent and decision-makers have therefore been able to rationalize cuts in maintenance budgets, especially when funds are low and infrastructure is still functioning.

With routine maintenance inadequately managed, infrastructure assets have been allowed to slowly run down, to the point where they become obsolete. However, in recent years, the Government has shown increased recognition of the importance of public infrastructure. Infrastructure rehabilitation features prominently in the MTDS and has been substantiated with major appropriations in recent Development Budgets and Supplementary Budgets. Care must be taken, however, to prevent Government entering into a vicious cycle of rehabilitation and neglect of infrastructure. This approach is inefficient and places unnecessary costs on Government.

An improved approach to infrastructure maintenance would involve:

- Maintaining an inventory of all the public infrastructure assets in a sector;
- Valuing each asset;
- Calculating the annual maintenance needs of each asset, based on its value and a depreciation rate;
- Determining the current state of each asset and any rehabilitation needs; and
- Providing a rational basis by which rehabilitation and maintenance requirements are prioritised.

Such a system is already in place for National Roads: the Road Asset Management System (RAMS). This type of approach should be rolled out to other infrastructure assets of Government. Consideration should also be given to:

- Ensuring that there are clear incentives to carry out routine maintenance works;
- Specifying responsibilities and clear accountability mechanisms for carrying out maintenance works; and
- Establishing the process by which any new asset management systems can be managed and regularly updated.

### 6.5.3 Designing credible plans for rolling out services

The MTDS requires Government to roll out essential services to under-served areas. This poses a mammoth task. Such areas are usually remote and at present lack the most basic infrastructure. Capacity constraints in both the public and private sector make the task greater still. Determining the least cost approach to rolling out services and ensuring that new services are sustainable will emerge as one of Government's greatest challenges over the coming years.

## 6.6 DEVELOPMENT BUDGET 2008

Table 50 illustrates the summary data for the 2008 Development Budget. Of a total Development Budget of K1,887.1 million, K763.4 million originates from Government sources, whilst K1,123.7 million is contributed by development partners. K1,349.5 million of the total Development Budget is directly targeted at the seven MTDS EPAs.

**Table 50: 2008 Development Expenditure (Kina Millions)**

	2008 GoPNG	2008 Grants	2008 Total
MTDS Expenditure Priority Areas	499.7	849.8	1,349.5
Other	263.7	273.9	537.6
<b>TOTAL</b>	<b>763.4</b>	<b>1,123.7</b>	<b>1,887.1</b>

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 across the seven EPAs.

**Table 51: 2008 GoPNG Development Expenditure on MTDS Expenditure Priority Areas (Kina Millions)**

	Direct Financing	Tax Credit	Loans	Total GoPNG
Primary and Preventive Health	34.8	0.0	9.2	44.0
HIV/AIDS Prevention	17.0	0.0	0.0	17.0
Basic Education	10.5	0.0	0.0	10.5
Dev-Oriented Adult Education	3.3	0.0	0.4	3.7
Transport Rehab and Maintenance	148.0	73.7	116.4	338.1
Income Earning Opportunities	38.4	0.0	17.0	55.5
Law and Justice	31.0	0.0	0.0	31.0
<b>Sub-Total</b>	<b>283.0</b>	<b>73.7</b>	<b>143.0</b>	<b>499.7</b>
Other	243.7	0.0	20.0	263.7
<b>TOTAL</b>	<b>526.7</b>	<b>73.7</b>	<b>163.0</b>	<b>763.4</b>

Source: Department of National Planning and Monitoring

Table 52 below shows the level of direct financing to each of the seven EPAs in 2008 relative to funding in 2007.

**Table 52: 2008 versus 2007 GoPNG Development Expenditure Direct Financing on MTDS Expenditure Priority Areas (Kina Millions)**

	2007 GoPNG	2008 GoPNG	Change	Change (%)
Primary and Preventive Health	45.0	34.8	-10.2	-22.7%
HIV/AIDS Prevention	12.5	17.0	4.5	36.0%
Basic Education	26.9	10.5	-16.4	-61.0%
Dev-Oriented Adult Education	3.5	3.3	-0.2	-5.7%
Transport Rehab and Maintenance	159.8	148.0	-11.8	-7.4%
Income Earning Opportunities	51.5	38.4	-13.1	-25.4%
Law and Justice	30.5	31.0	0.5	1.6%
<b>Sub-Total</b>	<b>329.8</b>	<b>283.0</b>	<b>-46.8</b>	<b>-14.2%</b>
Other	179.3	243.7	64.4	35.9%
<b>TOTAL</b>	<b>509.1</b>	<b>526.7</b>	<b>17.6</b>	<b>3.5%</b>

Source: Department of National Planning and Monitoring

The majority of the Government's expenditure outside of the seven 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 again high in 2008 due to buoyant production levels across Papua New Guinea's extractive industries increasing the value of SSGs and greater commitment by 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 53: 2008 GoPNG Development Expenditure Outside of MTDS Expenditure Priority Areas (Kina Millions)**

	Direct Financing	Tax Credit	Loans	Total GoPNG
Governance Reform	16.1	0.0	15.3	31.4
General Government Administration	10.8	0.0	0.0	10.8
Aid Administration	0.0	0.0	0.0	0.0
Constitutional Grants	54.5	0.0	0.0	54.5
Development Grants	133.0	0.0	0.0	133.0
Other Government Services	29.3	0.0	4.7	34.0
<b>TOTAL</b>	<b>243.7</b>	<b>0.0</b>	<b>20.0</b>	<b>263.7</b>

Source: Department of National Planning and Monitoring

In all, 82.7 per cent of GoPNG expenditure in the 2008 Development Budget is estimated as being MTDS aligned. This compares to GoPNG's target of 88.5 per cent.

As in 2007, the Government has used indicative sector ceilings generated by the MTRF to guide its direct financing. Performance against these ceilings is detailed in the table 54.



**Table 54: Performance against 2008 Indicative Sector Ceilings (Kina Millions)**

	2008 Indicative Sector Ceilings	2008 Budget Appropriations	Difference
Primary and Preventive Health	33.8	34.8	1.0
HIV/AIDS Prevention	30.9	17.0	-13.9
Basic Education	25.3	10.5	-14.8
Development Oriented Adult Education	7.3	3.3	-4.0
Transport Rehabilitation and Maintenance	156.3	148.0	-8.3
Income Earning Opportunities	38.6	38.4	-0.2
Law and Justice	46.9	31.0	-15.9
Governance Reform	6.3	16.1	9.8
General Government Administration	2.1	10.8	8.7
Aid Administration	0.2	0.0	-0.2
Constitutional Grants	54.5	54.5	0.0
Development Grants	97.3	133.0	35.7
Other Government Services	17.2	29.3	12.1
<b>TOTAL</b>	<b>516.7</b>	<b>526.7</b>	<b>10.0</b>

Source: Department of National Planning and Monitoring

The ratio of GoPNG to donor expenditure is mixed due to an increase in donor expenditure and GoPNG development expenditure outside of the 7 EPAs.

**Table 55: 2008 GoPNG Development Expenditure Versus Donor Expenditure (Kina Millions)**

	2008 GoPNG Development	2008 Donor Grants	2007 Ratio	2008 Ratio
Primary and Preventive Health	44.0	132.0	1:2	1:3
HIV/AIDS Prevention	17.0	84.3	1:8	1:5
Basic Education	10.5	163.1	1:3	1:16
Dev-Oriented Adult Education	3.7	0.0	4:1	-
Transport Rehab and Maintenance	338.1	220.8	2:1	2:1
Income Earning Opportunities	55.5	141.4	1:1	1:3
Law and Justice	31.0	108.3	1:2	1:3
<b>TOTAL/AVERAGE</b>	<b>499.7</b>	<b>849.8</b>	<b>1:1</b>	<b>1:2</b>

Source: Department of National Planning and Monitoring

When account is also taken of recurrent and the additional priority expenditure, it can be seen that 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 56: 2008 GoPNG Total Expenditure Versus Donor Expenditure  
(Kina Millions)**

	2008 GoPNG Recurrent & Development	2008 Donor Grants	2007 Ratio	2008 Ratio
Primary and Preventive Health	679.7	132.0	5:1	5:1
HIV/AIDS Prevention	22.7	84.3	1:5	1:4
Basic Education	713.7	163.1	8:1	4:1
Dev-Oriented Adult Education	19.5	0.0	10:1	-
Transport Rehab and Maintenance	623.9	220.8	3:1	3:1
Income Earning Opportunities	456.3	141.4	3:1	3:1
Law and Justice	503.7	108.3	7:1	5:1
<b>TOTAL/AVERAGE</b>	<b>3,019.6</b>	<b>849.8</b>	<b>4:1</b>	<b>4:1</b>

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