

SUB NATIONAL FUNDING FOR EFFECTIVE, EFFICIENT AND EQUITABLE SERVICE DELIVERY & DEVELOPMENT

Key Note Address

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Introduction

Hon. Richard Maru – Minister for National Planning & Monitoring

Professor Frank Griffin –Vice Chancellor, University of PNG, Professor Stephen Howe, ANU, Professor Pilai, UPNG

Distinguished Guests, Ladies & Gentleman

I am humbled and at the same time privileged and honored to stand before you all important people to address you in this very important forum.

Many of you here today are experts, well versed and knowledgeable in these areas of development and diversity. However in my address, I will briefly touch on an area that I am more familiar with. It is also closely related to the theme of this 2019 PNG Update forum, 'Development & Diversity'. The title of my presentation is: **Sub National Funding for Effective, Efficient and Equitable Service Delivery and Development.**

Development

Development is concept that can mean many things to different people. However every development effort undertaken in whatever capacity and nature must have meaningful and lasting outcomes. In the final analysis, real development must be reflected in the quality of the lives of majority of our population in the rural areas. The current Marape-Davis government's vision and theme is to, 'Take Back PNG and make PNG the Richest Black Christian Nation'. This vision is about taking back the quality and dignity of the lives of our people. And a rich black nation is one where the quality of life of its population is much better compared to other group of people or nations. The majority of our people must be healthy, wealthy, educated, security, be mobile, have be free and have equal standing in society. In order to achieve this standard and quality of life, we must have the good facilities and good service delivery systems in health, education, transport infrastructure, agriculture, commerce and industry, law and justice and that there must be equal opportunity for all our citizens.

Diversity

Development is very challenging in a country like PNG that is diverse in so many ways. The nation is so diverse culturally, linguistically, ethnically, geographically and economically. No two districts or provinces are alike. This needs to be taken into account by all when designing and implementing any programs to bring development to our people. The resource base for districts and provinces are not the same. The cost of delivering the same set of services are different from district to district and province to province. The demographic composition also differs from district to district and province to province. In the context of development, the diversity of the districts and provinces must be taken into account so that there is equal opportunity for all Papua New Guineans to participate in the social and economic development of the wards, councils, districts, provinces, regions and the nation as a whole. As the Prime Minister, Hon. Marape has alluded to, 'No child must be left behind'. No citizen must be left behind, no matter where they in PNG.

For real development to take place a lot of effort and input is needed from everyone concerned in all facets of society. These include the government machinery from the national to the sub national government, the private sector and non- government organization, churches, development partners and more importantly, the people themselves.

There is a general understanding that basic services in many provinces and districts are deteriorating but it is not clear as to why this is happening. The reasons are complex and require collaborative effort and input from all stakeholders to bring real progressive development to all parts of the country. However, it is commonly known that inadequate financing or funding is seen as a major impediment. Adequate funding is one of the key inputs needed to provide effective and efficient service delivery. However providing the right level of funding, to the right sector or community using the right methods /means and making funding available at the right time is paramount to achieving lasting service delivery outcomes.

The National Economic & Fiscal Commission (NEFC)

The NEFC is a Constitutional Office provided for under the *Constitution and the Organic Law on Provincial Governments and Local Level Governments*. Its roles and functions are spelled out specifically in *Section 187H of the Constitution and Section 117 of the Organic Law on Provincial and Local Level Governments* as well as the *NEFC Act 2009*.

The overarching role of the Commission is to provide economic and fiscal advice to the national government including advice on intergovernmental financing arrangements. This is entrenched in the *Intergovernmental Relations (Functions and Funding) Act 2009* and gives the NEFC a number of specific responsibilities which include providing advice to the Treasurer on the amount of recurrent non salary grant funding that Provincial and Local Level Governments should receive each year.

The NEFC as an initiator of reforms in Intergovernmental Financing Arrangements (RIGFA) needs to continue to work in partnership with the Departments of Treasury, Finance, Provincial Affairs and Local-level Government affairs, Implementation and Rural Development and PLLSMA to enable provincial governments to fulfill their service delivery functions.

Intergovernmental Financing Arrangements

There are many ways in which the national government can transfer funds to the sub national governments with the purpose of achieving certain objectives. These fiscal transfers must ideally match the expenditure needs at various levels of sub nationals. Intergovernmental financing transfers if designed and implemented properly, can help to achieve national, regional, and local objectives, such as fairness and equity, and to create unity in PNG as one nation. It can also help the national and sub-national governments to achieve better fiscal management, macroeconomic stability, distributional equity, allocative efficiency, and public service delivery.

In late 2001, The NEFC was tasked by the National Government to review the then existing intergovernmental financing system and come up with a better system. Subsequently after much research, consultation, legislative changes and engagements with key stakeholders, the Reforms in Intergovernmental Arrangements (RIGFA) was approved by parliament and implemented in early 2009. These reforms were based on best international practice and has been considered as one of the most successful reforms in the country if not the pacific region. I will now share with you the background, achievements, key learnings and issues encountered of the reforms and possible way forward options in intergovernmental financing arrangements.

Old System

The old system of fiscal decentralization at that time was seen as not living up to its expectations for improved service delivery. One of the criticisms labeled at the old system was that it was not based on a sound understanding of the problems in intergovernmental financing systems. Some notable key observations made were service delivery was deteriorating, national and provincial governments in some cases had different priorities, confusion over functions, differential capacity was not accommodated, resources were inadequately distributed among provinces, provinces' internal revenue were not taken into account, the equal kina per head or per capita based grant system was not affordable given funding arrangements at that time and the implementation of system itself was not in accordance the design of the system. The observations and the lessons from the old system were taken into account and incorporated in the design and implementation of the new system which is now referred to as the Reforms in Intergovernmental Financing Arrangements (RIGFA). RIGFA moved away from the old per capita funding system to a "Needs" based funding system in 2009.

Reformed System – RIGFA

The vision of the reformed system was that each person in PNG has equal access to basic services no matter where they live. For instance it is relatively cheaper to deliver services in the Southern Highlands Province because it is well connected by the road system and the population live relatively close to each other compared to Sandaun which is a very large province with the population quite spread out and only one out of the three districts can be accessed by road from the provincial capital.

It is pleasing to note that the Marape - Steven Government has reaffirmed the same aspiration to ensure equal access to basic services so that no child must be left behind no matter where they live. The vision can be achieved through policy and workable and practicable arrangements that would enable provinces enough funding to deliver a similar set of basic services. The key means of achieving this was by sharing the available funding based on need.

RIGFA was designed and implemented using best international practice and based on the following core principles in Fiscal Decentralization. *Affordability* –the national and sub national governments must have adequate funding to implement the system. *Funding follows function* – functions at each level of government must be clearly identified and established so that appropriate funding can be allocated accordingly. *Responsibility Specifications* – Who will do what at the sub nationals must be

clearly identified and established. *Transparency and accountability* – there must be processes and systems in place with strong governance framework to ensure that funds are channeled and accounted for at each level of sub national government. The other important principle is that there must be a *consistency of funding system* to ensure that service delivery plans and efforts are not affected at the sub nationals.

Cost of Service

In order to provide any funding for development or recurrent purposes, we must know how much it will cost to provide a specific set of services. This will at least form a good basis for determining how much is needed to fund targeted service delivery activities. In determining what funding requirements the provinces and local governments need, the NEFC undertakes a comprehensive study every 5 years to establish basic costs of services. The study includes intensive planning and field visits to all provinces, including districts to capture relevant data that will form the basis for establishing costs of delivering specific services in the districts and provinces. Even though the field study is conducted every 5 years, the costs estimates are updated every year taking into account population growth and annual inflation rate as measured by the consumer price index. The next full and expanded cost of service study will be undertaken in 2020.

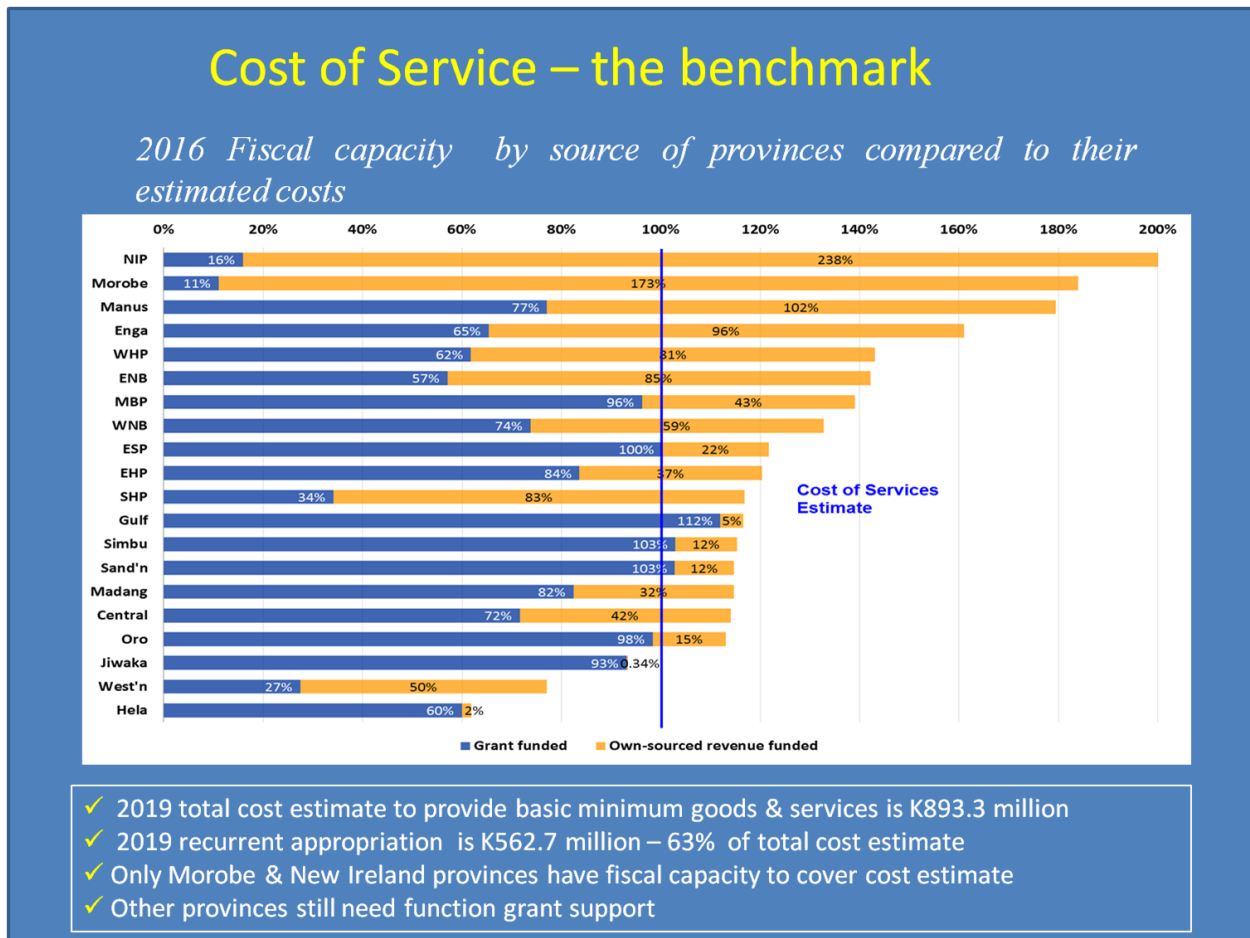
Fiscal Capacity & Provinces Own Source Revenue

After the cost of delivering a basic set of services in the provinces is identified and established as the benchmark, the Commission critically looks at the each province's fiscal capacity. As the theme of this forum says 'development and diversity' no two districts or provinces are the same in every aspect. All provinces, districts and communities are different. In terms of fiscal capacity, all provinces are different. Some provinces are rich in terms of raising their own internal source revenue while others have very low economic bases to raise enough revenue to meet their expenditure requirements in service delivery. In designing the reforms, the Commission also took into account the disparities in fiscal capacity among provinces. This helps in determining the level of support in funding needed from the national government for individual provinces. Internal revenue is an important factor taken into account when determining the fiscal need of each province.

Fiscal Gap & Equalization Principle

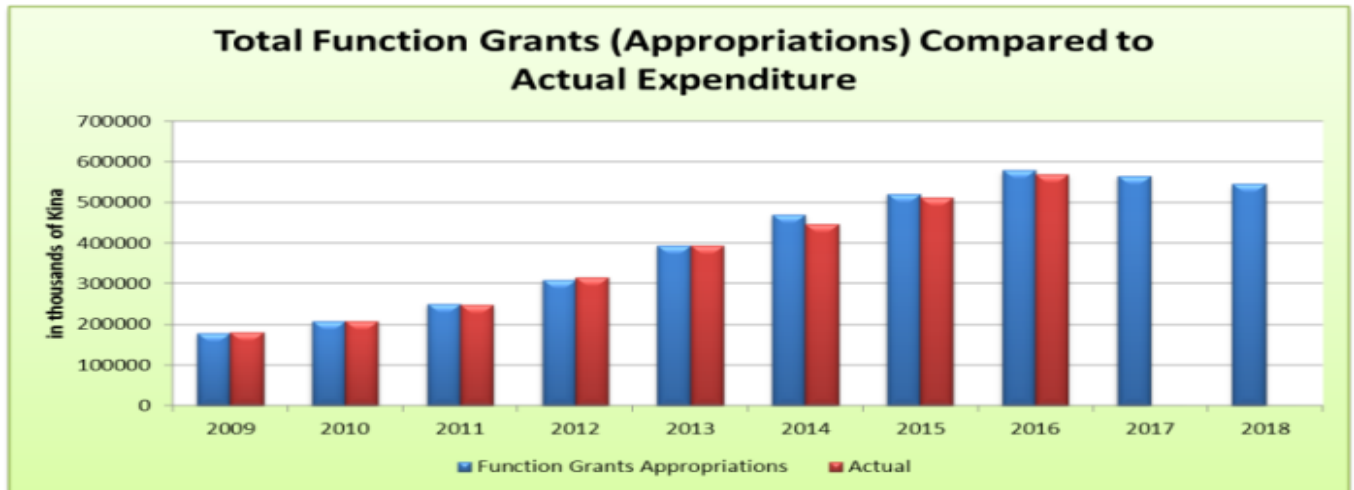
The fiscal gap is the difference between the province's own internal revenue and estimated cost of delivering a basic set of services in the province. The gap or fiscal need is the equalization funding that a province needs to at least provide a basic set of services. The equalization principle applies to all the provinces except NCD and ARoB which do not fall under the equalization system since they come under their own separate legislations. The Commission estimates that in order to provide all the basic services, it will cost around K1 billion a year. These are conservative estimates and the figure could be higher. However in terms of recurrent funding, appropriation every year is just half or in some years below half of this amount. Another impediment is that the equalization pool of funding that the national government provides for the recurrent appropriation is fixed at 6.57% of the

National Government’s Net National Revenue (NNR). This is the government’s Gross Taxable Revenue less the Tax from Mining and Petroleum. The exclusion of the mining and petroleum tax is to ensure a steady flow of revenue given the volatile nature of the price of commodities from the extractive industries. For example the Commission’s total Cost of Service estimate for 2019 was K893.3 million but the equalization amount appropriated under the existing arrangements was K562.7 million, indicating that we are only appropriating 63% of total funds needed to provide just basic set of services. The balance of the costs are expected to be funded from internal revenue from the provinces for those that have the capacity. Refer to the graph below.



Success of the Reforms

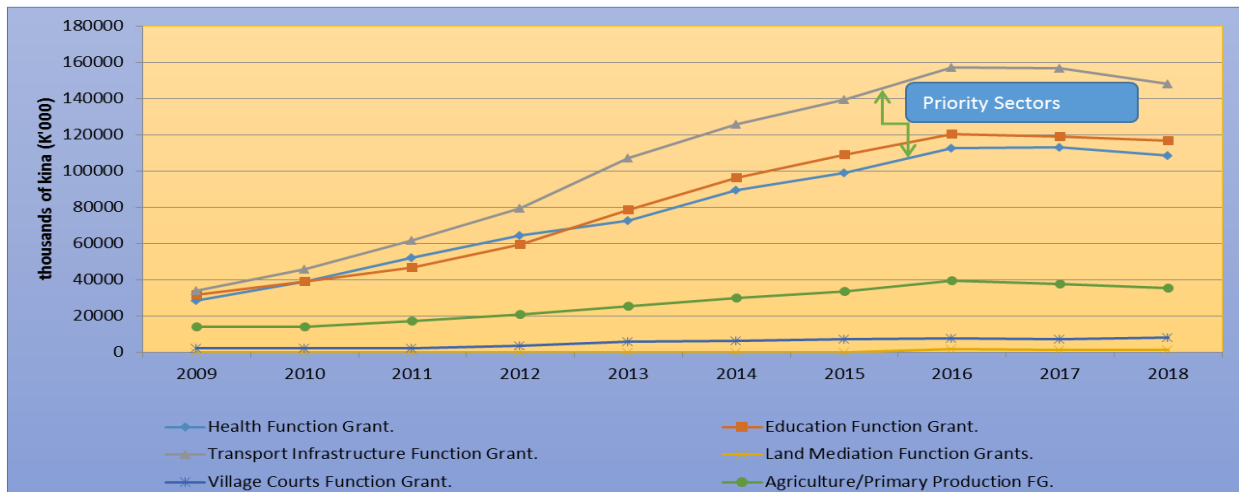
The graph below shows eight annual progressive increases in function grants appropriations between 2009 and 2016 to provinces and Local-level Governments (LLGs). The total allocation of function grants to provinces and LLGs amounted to approximately K4 billion between 2009 and 2018 representing significant allocation of funding transfers from national to sub national governments. The appropriations are represented by the blue bars and red bars represent the actual spending by the provinces. The graph indicates that the reforms have been successful in terms of function grants appropriations (i.e. recurrent funding to sub-national governments) and are matched by actual expenditure by provinces.



* Function grants appropriations and expenditure over the last 10 years. Expenditure figures for 2017 & 2018 are yet to be published

Targeted Funding for Key Service Delivery Sectors

One key successes in reforms in sub-national funding arrangements was that funding was now targeted at key priority sectors.. Provinces are now required to focus on funding service delivery activities in the key sectors of Health, Education, Transport & Infrastructure, Commerce & Agriculture and Law and Justice. We have witnessed funding for these sectors increased over these years and these are good results.



Monitoring Provincial Expenditure

Since the reforms were implemented, the NEFC has also initiated steps to monitor the performance of provinces that were receiving the function grants or goods and services grants. This is one of the key successes of the reforms. The NEFC, in working with provincial governments is able to track the use of function grants at the provincial level. NEFC is probably the only institution in the country that can monitor public monies at the provincial level consistently on annual basis. Thus we cover both ends of the funding – making recommending to the national government the recurrent funding each provincial government should receive and later follow up by monitoring of how these funds are

expended at the provincial level. There is still a lot of room to track expenditure right down to the facility levels, an area the NEFC has begun exploring but needs greater effort, work and commitment from everyone as discussed below.

Partnerships & Engagement

The reforms were successful because it was a collaborative effort from everyone including national departments – the Department of Prime Minister & NEC, Departments of Provincial & Local-level Government Affairs, Treasury, Finance, Planning and Monitoring and the provincial governments, districts & LLGs and also the development partners – particularly DFAT who have been with the NEFC from the beginning and up until to now.

The NEFC has been conducting regional workshops in each region of the country every year. These two day workshops are very important and have attracted many participants from the sub-national governments, national agencies, development partners and others as well. Key participants are from the provinces and districts who come together to share their experiences, achievements and issues relating to the use of function grants and also provide possible solutions to provide service delivery at the provincial and district levels.

Facility Based Funding Reviews

The NEFC has taken a step further to review the progress of the reforms in intergovernmental financing arrangements at the front line of service delivery. This involved the assessment of Facility Based Funding - Diagnostic Expenditure Reviews (FBF-DER). The FBF DER was intended to provide an in-depth analysis of the allocative efficiency of funds channelled down to the facilities from National Government to provinces and to the front lines of service delivery. Over the years the National Government has increasingly allocated function grants to the provinces and LLGs for service delivery activities in targeted key sectors of Health, Education, Transport & Infrastructure and Primary Production, including Agriculture. The FBF review was conducted to assess if these function grants as well as other grants are reaching the facilities on time and used as per the sub national plans and budgets. It was expected that the review will provide a more accurate analysis of the allocative efficiency of funds channeled down, including the actual amount allocated for service delivery activities at the front line facilities. The results of the review done particularly for health and education sectors, showed that only 20% of the appropriated funds actually reach the facilities. This is a big concern as the money is not going to the facilities and has probably contributed to the poor service delivery at the districts.

Key Challenges

Cash Release Delays

Delay and inconsistency of release of function grant funds to the provinces on time continues to be a bottleneck that affects the planning and implementation of service delivery programs and activities at the sub national levels (refer diagram below). Delays of over six months between warrants and

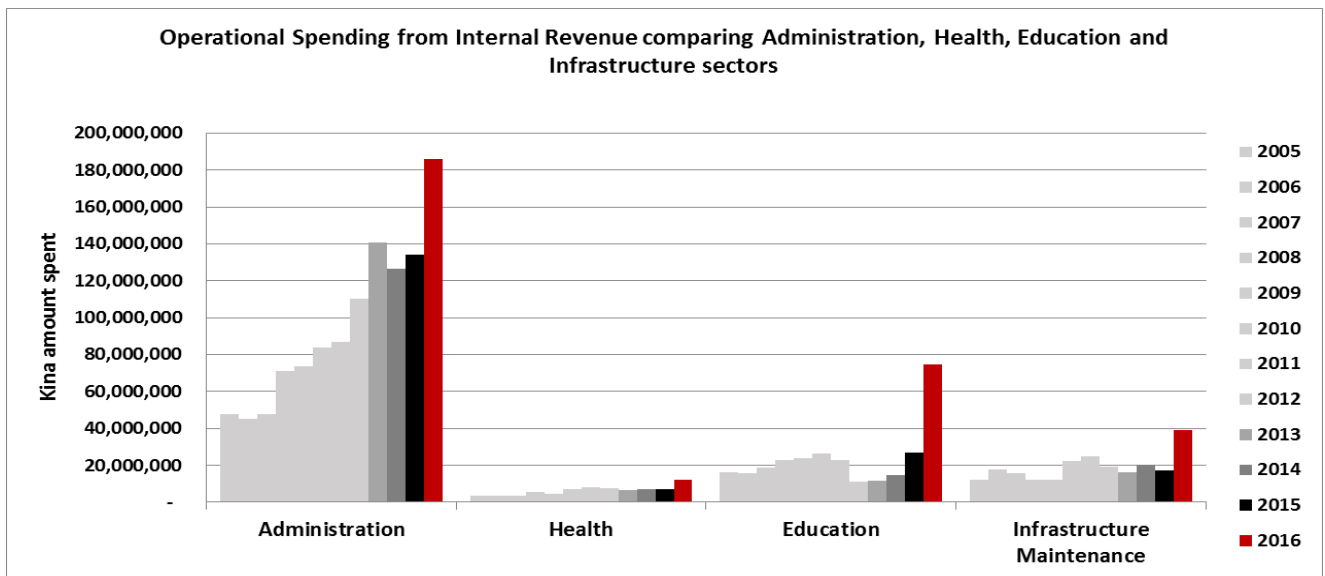
cash releases were identified by NEFC. Releasing bulk of the funds in the last quarter also increases the risk of use of funds for unintended purposes.

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
% of cash released (2016)	2%	9%	28%	61%
% of cash released (2017)	2%	18%	32%	48%

* Much of the cash for appropriated grants are released in the last quarter hence affecting service delivery plans and activities.

Provinces Not Prioritizing Internal Revenue

A review of the provincial expenditure reports over the years highlight that provinces, especially resource rich provinces are failing to prioritize or spend more of their internal revenue to fund expenditure on basic service delivery. It has been noted that provinces spending in non-main service delivery sectors, such as spending for administration purposes have continued to increase over these years (refer graph below). This needs to be controlled and more money need to be allocated for service delivery sectors of health, education, transport and infrastructure, agriculture and law & justice.



*Total Provinces' Own Source Revenue spending by sector. Spending on Administration purposes continue to increase each year.

Governance and Accountability Issues

Systems of checks and balances must be built into government structures that will form the core of good governance at all levels of government in PNG. The success of our service delivery efforts will directly depend on our country's governance and accountability frameworks. PNG continues to suffer from unsatisfactory, inappropriate, dysfunctional governance and weak monitoring systems which results in inappropriate allocation, mismanagement and abuse of resources at all levels of the government. The results are obviously the deterioration of our health, education, infrastructure and law & justice systems despite the increase in funding appropriation over the last decade. Therefore sound sector management and good governance at both at the national and sub-national levels of

government is critical to achieving our development aspirations. In terms of function grants appropriation, it has been noted that total of more than K4 billion has been appropriated to the sub nationals over the last 10 years.

Less Funds Reaching Facility Levels

It has been revealed in the NEFC's facility based funding reviews that only 20% of the funds appropriated for the health and educations sectors is reaching the facilities. This is a critical issue and needs further studies and reviews to ascertain the real causes and find appropriate solutions so that appropriate funding reaches the facilities.

Parallel Funding of Sub Nationals

There is a lot of funding going to the sub nationals from the national government through many channels. Function grants or recurrent funding is appropriated through NEFC based on cost of service estimates and provinces' fiscal capacity and also taking into account the equalization principles. There are other streams of funding going to the sub national government such as the development grants (PSIP & DSIP), tuition free fee (TFF) and other funding by the national departments and agencies. It is noted that there is no proper integrated coordination and management of these funds in terms of reporting, monitoring and also no proper governance frameworks regarding the accountability aspects of using these resources. The department of Provincial and Local-level Government Affairs has initiated a service delivery agreement between the provincial governments and the DDAs as a means to ensure effective use of funds. This will hopefully address the situation.

Way forward/Opportunities

Integrated and Holistic Approach

If we are going to make real progress in development in a country so diverse as PNG, we need to work together. It has to be a holistic and collaborative effort by everyone involved in bringing services to our people. There must be a system to fully integrate all sub national funding as one grant system. There must also be a fully integrated governance framework with efficient monitoring and reporting structures in place for accountability and measuring outputs at all levels from the national to the sub-national levels of government.

Release Function Grants Cash on Time

We understand that the amount of funding that goes to the sub nationals virtually depend on the general economic performance, the national government's fiscal capacity and the its priorities in spending. However we must also understand that our people need basic services and it is not proper to deny them that right. Functions grants are meant to be used to deliver the basic service needs in health, education, transport & infrastructure, agriculture and law and justice at the province, district and community levels. It would be good if the government can treat function grants in the same

order of priority as debt servicing and the public servants salary payment obligations when it comes to prioritization of funding.

Provinces to Increase Funding in Priority Sectors

A review of the provincial expenditure reports over the years highlight that provinces, especially resource rich provinces are failing to prioritize or spend more of their internal revenue to fund expenditure on basic service delivery. It has been noted that provinces spending in non MTDP sectors, especially spending for administration purposes have continued to increase over the years. This needs to be controlled and more funding needs to be allocated for service delivery sectors of health, education, transport and infrastructure, agriculture and law & justice.

Scope to Fund Direct to Facilities

The front line delivery points or the facilities are key strategic points to bring service delivery to our people. There is great scope for direct funding of facilities which can greatly cut out bureaucratic red tape and other hassles. The logistics and practicalities of managing and monitoring a greater number of facilities are quite challenging. However this is an area that that needs further work as it is crucial that funds must reach facilities on time in full.

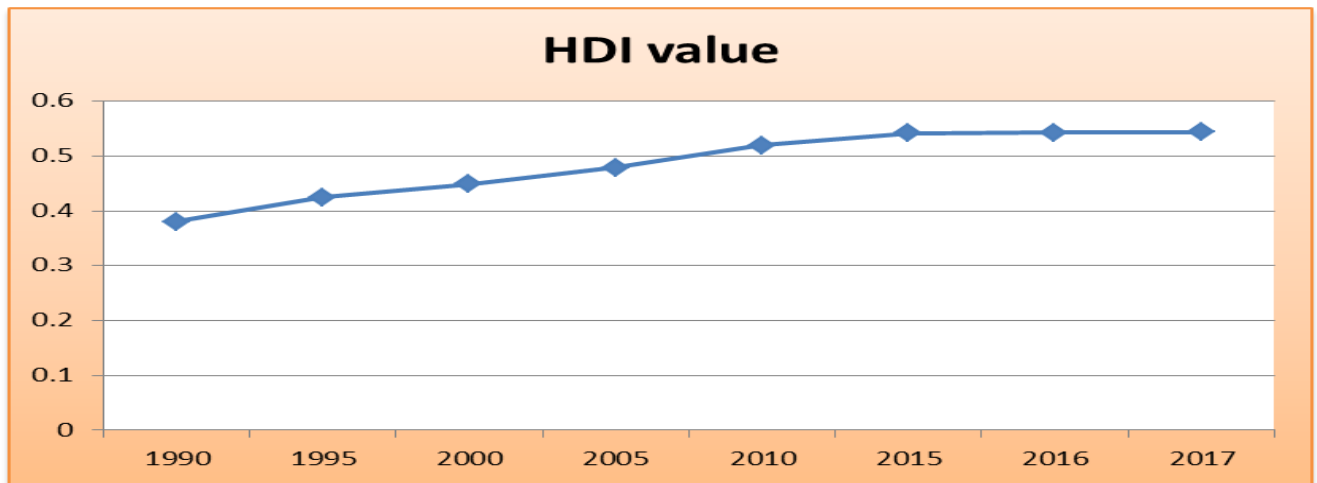
Some current NEFC Initiatives

Review of Intergovernmental financing arrangements and the implications of fiscal decentralization for the provinces mooted for autonomy.

The government has progressed in the area of greater gradative decentralization or financial and administrative autonomy for the provinces. This initiative will give greater responsibilities and empower provinces to make decisions and be responsible for decisions they make. The NEFC has used Technical Assistance under DFAT funding to review the current intergovernmental financing arrangements (IGFA) and fiscal decentralization implications for the provinces mooted for autonomy. Further work will continue in collaboration with other relevant stakeholders.

Concluding Remarks

It has been highlighted that function grants (recurrent) alone transferred to the sub-national governments amounted to more than K4 billion in the last 10 years. Though there have been delays in releases of funds to the provinces, the actual expenditure is very close to the appropriation amounts meaning that money is actually reaching the sub-national levels of government. There are other huge parallel funding going to the sub national level which includes development funds (PSIP & DSIP), Tuition Free Fee (TFF), and other direct funding by national departments and agencies, donor and development partner funding, churches and NGOs spending, Tax Credit scheme spending and many others. Total funding to sub national level of governments in any year could amount to hundreds of millions of kina each year.



**The value of the Human Development Index from 1990 to 2017*

Whilst greater funding is being made available to sub-national level of government, this appears have had a negligible impact on PNG's global human development indicator value (refer to above graph). This can be confirmed by looking at the status of our basic service delivery facilities and the provision of basic services in all our districts in the country. Perhaps funding is not the only issue. It is probably the way we conduct our business in the public sector from the national level to all levels in the sub national and all the way to the front line of service delivery – the facilities. As highlighted if only 20% of funds are reaching the facility levels, there is something wrong somewhere. This is something that we all should seriously think about and look at finding solutions to ensure that effective and efficient service delivery takes places at the facility levels.

Thank you Ladies and Gentlemen.