



WOK BUNG WANTAIM

USING SUBNATIONAL GOVERNMENT
PARTNERSHIPS TO IMPROVE
INFRASTRUCTURE IMPLEMENTATION
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6 ADB Avenue, Mandaluyong City, 1550 Metro Manila, Philippines
Tel +63 2 632 4444; Fax +63 2 636 2444
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Currency Equivalents

(as of 9 October 2015)

Currency unit	-	kina (k)
K1.00	=	\$0.340
\$1.00	=	K2.94

Abbreviations

ADB	-	Asian Development Bank
CSTB	-	Central Supply and Tenders Board
DDA	-	District Development Authority
GDP	-	gross domestic product
JDPBPC	-	joint district planning and budget priorities committees
JPPBPC	-	joint provincial planning and budget priorities committees
LLG	-	local level government
LNG	-	liquefied natural gas
NEFC	-	National Economic and Fiscal Commission
PLLSMA	-	Provincial and Local-Level Service Monitoring Authority
PMU	-	project management unit
PNG	-	Papua New Guinea
SIP	-	Services Improvement Program

Glossary

- main ADB project – an ADB-financed project implemented by a national agency
- local infrastructure partnership – a partnership among ADB, the national implementing agency, and a province or district to include a local infrastructure project as an addition or contract variation to a main project to achieve procurement synergies
- local infrastructure project – a project funded by provincial or district administrations

Executive Summary

The dramatic increase in devolved grants to provinces, districts, and local governments (i.e., subnational entities) in Papua New Guinea (PNG) since 2012 has introduced around \$600 million per year in additional subnational funding. In 2013, subnational funding comprised roughly 25% of total national government expenditure, up from just 14% the year earlier. This new funding is being delivered primarily through the use of constituency funds with members of Parliament (MPs), provincial governors, and local government administrators exerting a high degree of control over fund use. These rapidly expanding constituency funds are now being used to fund an array of capital projects for which subnational government entities have little experience in planning, contracting, and maintaining.

Government agencies and subnational administrations have had difficulty effectively spending their newly increased funding allocations. National government agencies underspent their capital budget allocations in 2013 by 19%, and 50% of the expenditure were deposits into trust accounts. Alas, across the government there is a lack of capacity to effectively translate higher spending allocations into actual infrastructure and service delivery.

This study aimed to examine whether the Asian Development Bank (ADB) could play a more direct role in assisting subnational entities to utilize their new funding sources by accepting them as a source of counterpart funding, and if ADB-financed projects have the desire, capability, and authority to accept and use this additional funding within the PNG Public Financial Management Act (1996). The primary objective would be to draw upon the existing implementation structures already established under ADB and National Government programs to channel local government resources towards priority infrastructure investments more effectively.

In the course of this study, it was revealed that government projects partly funded by ADB have already been utilizing subnational counterpart funding for several years, albeit informally. In some projects, project management units (PMUs) have been accepting counterpart contributions from open-electorate MPs for land surveys and design works for local infrastructure. For others, PMUs have directed MPs wishing to contribute to a project to use the funds to purchase the land covering the construction site or to compensate landowners.

Other projects report that they encourage the use of counterpart funding to address unexpected issues that arise in project delivery without accepting actual funds. One PMU encouraged a subnational entity, keen to partner in the project, to use funds to undertake

surveys and purchase land needed for project sites. It reported that this action allowed it to avoid unexpected costs, as the project design had incorrectly assumed that all the building sites were surveyed.

On the other hand, some PMUs have reported a reluctance to accept subnational counterpart contributions because of the lack of flexibility in their project scopes, and an absence of a clear engagement framework.

Given this initial feedback from PMUs, the study then aimed to identify how ADB could adopt a more proactive approach in partnering with subnational government entities and if a more coordinated framework of engaging with these agencies would be beneficial. The study found an affirmative answer and outlines a set of options for how such a framework could work.

Local infrastructure partnerships describe arrangements in which ADB and its national-level implementing agencies may foster deeper partnerships with subnational entities to support their capacity to deliver local infrastructure projects and improve the overall quality of their expenditure implementation. The study outlines forms that these partnerships may take, ranging from expanding project scopes in exchange for more counterpart funding, to working in partnership with subnational governments to ensure that ADB and their own investments are better planned and coordinated. These partnerships aim to leverage greater impact from ADB's existing investment and to provide opportunities for subnational entities to use their rapidly growing funds more effectively and more efficiently. PMUs will play a central role in these activities, with discussions with PMU team leaders indicating a strong desire to better utilize subnational counterpart contributions in projects given the potential benefits and limited expected additional work involved.

Local infrastructure partnerships must be undertaken on a largely opportunistic basis and can only occur where synergy exists between ADB projects and subnational entities' infrastructure priorities. The report recommends that ADB should not engage in local partnerships in areas not already a part of its ongoing national-level initiatives. This will be necessary to ensure that the scope of activities do not expand outside of the mutually agreed ADB-PNG Country Partnership Strategy, 2016-2020^a and ensures that national government coordinating agencies maintain their existing responsibilities for planning and oversight of loan financed investments. In developing new local government partnerships it will also be important for ADB and the government to consider the additional administrative burden placed on the PMUs.

The report concludes that local infrastructure partnerships may take on one of three variations:

- (i) **Joint projects.** An upfront agreement to accept additional counterpart funding from a subnational entity results in a local infrastructure project being bundled together with the main national infrastructure project. Design, scoping, procurement, and civil works are a single project.

^a ADB. 2015. *Papua New Guinea Country Partnership Strategy, 2016-2020*. Manila.

- (ii) **Supported projects.** Where a project is active in a province or district, the PMU supports the subnational entity to implement its project(s) by providing technical support and sharing any relevant documentation (e.g., architectural designs). Procurement and execution remains the responsibility of the subnational entity and is undertaken through the Provincial Supply and Tenders Board but is supported by the PMU.
- (iii) **Other enhancements.** Subnational entities commit counterpart funding to support the preparation of project sites selected as part of an ADB project or undertake some other project enhancement. For example, a subnational entity commits to securing land, compensating landowners to guarantee access by contractors, or providing funding for future maintenance in a contract.

Each variation constitutes a more formal approach to engaging with subnational entities than currently exists. Key advantages offered by the above approach include:

- (i) **Respond to government devolution policy.** Over the last 10 years, the national government has increased the powers of the province and district government levels. This has also been matched by an increase in funding allocations, particularly since 2011. Local infrastructure partnerships provide an opportunity for ADB to be responsive to this policy shift, aligning its operations more strongly with government priorities.
- (ii) **Improve risk management.** Formalizing how ADB engages with subnational entities and regularly reviewing the progress of these arrangements improves the ability of ADB and the national government to identify and manage potential risks that arise from growing subnational funding.
- (iii) **Increase the scale and impact of ADB projects.** Counterpart contributions from subnational entities provide an opportunity to increase the scale and scope of some projects, potentially improving the overall project's impact and social benefits. In particular, these funding sources appear particularly well suited for supporting smaller, community-level investments that help improve the inclusiveness of large ADB infrastructure projects.
- (iv) **Address bottlenecks across PNG's service delivery hierarchy.** PNG's decentralized system of service delivery is designed in a hierarchical manner to balance cost and access. Because each is managed by a different level of government, it becomes vulnerable to bottlenecks when problems occur at a single level. Subnational counterpart contributions provide additional flexibility to address infrastructure impediments in a holistic manner.
- (v) **Improve integration of national and local infrastructure investments.** Infrastructure planning systems in PNG are disjointed and suffer from a lack of coordination and often technical expertise. By engaging in local infrastructure partnerships, ADB can open up an entry point to support changes to planning systems, which may help in the design of future efforts to improve the integration between national and subnational infrastructure delivery.
- (vi) **Enhancing inclusiveness by supporting local infrastructure projects.** Local infrastructure projects have the potential to provide large social benefits, particularly when they provide social services or transport connections to isolated populations. However, development partners have traditionally had difficulty implementing these types of projects efficiently because they require strong

engagement and ownership at the local level. These types of projects also tend to be small-scale, one-off projects with very high contractor mobilization costs. By drawing on the local presence and expertise of existing implementation structures some of these challenges can be mitigated, particularly if ADB financed PMUs could be used to provide technical support for projects.

Partnerships are about providing capacity support in a manner that is sympathetic to the informal approach of PNG's subnational entities and recognize that key decision makers value interpersonal relationships with development partners and the PMU's charged with delivering the projects which they finance. This necessitates an on-the-ground focus that can only be provided by the PMUs, operating closely with the ADB PNG Resident Mission. The key tasks and support needed will almost always be undertaken at the project-delivery level, which reinforces the importance of the PMU. Under the approaches describes in this report, PMU's in partnership with PNG Resident Mission would play a vital role in identifying partnership opportunities to partner by engaging with key decision makers, facilitating partnership agreements between implementing agencies and subnational entities, and offering flexible support for the implementation of local infrastructure projects.

Any requirements of subnational entities to provide extensive proposal documents or dedicate key personnel will be a deterrent given their lack of capacity (particularly at the district level and below). Subnational entities are already overwhelmed trying to deliver projects and services. Local infrastructure partnerships would aim to relieve some of the burden on them by providing an alternate project delivery mechanism. As such, it is recommended that ADB project fact-finding missions and PMUs take a proactive approach when dealing with subnational entities to fully understand their circumstances.

A review of existing legislation, regulations, and guidelines indicates that current government public financial management rules could accommodate subnational counterpart contributions to ADB projects. For joint projects, subnational funds could be deposited in the project trust account and treated in the same manner as counterpart contributions from the national government. There would be scope for additional codes in the chart of accounts at the national and subnational level to more easily recognize these transfers. Yet, to provide certainty around the process, it is recommended that the Department of Treasury and the Department of Finance should issue specific financial and administrative instructions around subnational counterpart contributions.

To conclude this study suggests a number of important next steps necessary to support an expansion in local infrastructure partnerships. These include:

- (i) Improving oversight by PNG Resident Mission and project officers by undertaking a stock-take of existing subnational counterpart contributions or parallel funding arrangements across ADB's PNG loan portfolio. Where an informal arrangement exists between the PMU and a subnational entity, the review should undertake a risk assessment to determine the capacity of PMU to deliver core responsibilities and the likely administrative burden of the informal partnership, whether synergies exist between the national and subnational projects, and opportunities to add additional value to the partnership.

- (ii) Issuing advice to PMUs and project teams detailing a framework for engaging with subnational entities. The framework should provide guidance on with whom the PMUs should engage and at what stage in the project lifecycle. Advice also needs to be provided to subnational entities on the appropriate public financial management processes to engage with development partners. ADB may also usefully provide technical support to the Department of Treasury and Department of Finance to issue finance instructions to subnational entities around entering into local infrastructure partnerships.
- (iii) Piloting a more formalized approach, possibly a joint project in the transport sector, and a supported project in the health sector. The performance of these pilots should be evaluated. Systems should be established in the PNG Resident Mission to ensure lessons learned in each pilot are shared across projects.
- (iv) Strengthening the incorporation of opportunities to partner with subnational entities into project-scoping and review missions. When project officers visit PNG, dialogue and briefings should occur on subnational reform and financing issues, as well as meetings with key subnational actors within the project catchment areas.

Decentralization and Its Impact on Subnational Infrastructure and Service Delivery

Background

The overarching impact of decentralization on fiscal management and service delivery is multifaceted and still evolving. A detailed description of current subnational institutions and service delivery responsibilities are described in detail in Appendix 1. For the purposes of this summary, however, it is useful to highlight how reforms have impacted on two particular aspects of this landscape. Firstly, the impact which decentralization has had on the respective service delivery responsibilities between levels of government. Secondly, the impact which decentralization has had on the administrative processes and systems that are in place to guide public investment by subnational governments.

Efforts to decentralize PNG's system of government have been underway since before the country gained independence in 1975.¹ The most significant changes relevant to this study, however, began in 1995 as part of a major set of reforms aimed at improving service delivery, particularly in rural areas. This took place through a revision to the Organic Law of Provincial and Local Level Governments which is the key legislative instrument underpinning government decentralization in PNG. The reforms removed previously elected provincial assemblies, replacing them with provincial governments comprising the national MPs from the province and heads of local-level governments (representing each of the country's 89 districts).

The reforms also gave increasing autonomy and responsibilities to local level governments (LLGs) making them a sub-entity of the national government, rather than of provincial governments. They also introduced minimum per-capita funding arrangements for provinces and increased funding to LLGs. Public servants were relocated from urban centers to districts and stations nearer to the majority of people in rural areas.

As part of this process, both provinces and LLGs were assigned a series of specific service delivery responsibilities, known as functional assignments that had previously come under the mandate of national government.² As a result, a new much large variety of players—provincial governments, district development authorities,³ and provincial health authorities

¹ May, R. 2011. *Policy Making in Decentralization*. In May, R., 2011. *Policy Making and Implementation: Studies from Papua New Guinea*. Australian National University. Canberra.

² Government of PNG. 2009. *The Handbook on the Determination of Service Delivery Functions and Responsibilities*. Port Moresby.

³ *The District Development Authority Act (2014)* is the most recent reform to the structure and reporting lines of decentralized governance in PNG. The reform continues the trajectory of devolving operational authority and financial powers.

(i.e., subnational entities)—became important cogs in the delivery of services and infrastructure across the country.⁴

The 1995 reforms to the Organic Law of Provincial and Local Level Governments further established joint provincial planning and budget priorities committees (JPPBPC) and joint district planning and budget priorities committees (JDPBPCs) in each province. Each JDPBPC consists of the MP representing the open electorate (as chair), the provincial MP, the heads of the LLG in the district, and up to three other members. JDPBPCs were designed to adopt a largely administrative role: approving the LLG budget and making recommendations to the Provincial Government on budget allocations and drawing up the 5-year district development plan. In reality, the JDBPC were responsible for far more than this and often became involved in the implementation of plans and programs at the district level. These more ‘hands on’ activities often took place under hazy legal frameworks with JDBPCs and their respective LLGs unable to legally enter in contracts or to be the owner of state assets.

The JPPBPCs were given similar functions at the provincial level however also faced their own issues of effectiveness. As highlighted by May (2011: 217)⁵ “[i]n some districts the JDPBPCs have played an effective role; in others they have met infrequently, and often outside the district (in several cases in Port Moresby). A critical factor in this is the role played by the open MP. Apart from the question of whether the JPPBPC/JDPBPCs work effectively, there is an inherent problem in these arrangements in that such ‘bottom-up’ planning means that provincial priorities are not necessarily consistent with national priorities laid down in the MTDS and embodied in the policies of national departments.”

More recently, the government has pushed further ahead with the decentralization agenda. In May 2014, the Organic Law of Provincial and Local Level Governments was amended to abolish Joint District Budget Planning Committee’s (JDBPLC’s) to facilitate the creation of District Development Authorities (DDAs). The creation of DDA’s, which was finalized through the passage of a District Development Authorities Act in 2014, is designed in large part to formalize and strengthen the role of the JDBPC introducing a legal framework for their ownership of assets, contracting, and expenditure management. DDA’s have also been given much greater control over expenditure decisions. Provided a DDA can show compliance with the Public Finance (Management) Act, then the Minister for Finance can approve the establishment of a District Development Authority Supply and Tenders Board in the district. By removing the need of DDA to undertake contracting and procurement through provincial government systems this reform has been designed to speed up the tender process.

⁴ As such, the 1995 reforms have fractured services delivery reporting lines and seriously affected services delivery. Prior to the reforms, services delivery systems exhibited a high level of vertical integration, with reporting lines organized by sector (e.g., health workers reported to provincial health offices, which reported to the Department of Health). The reforms changed these reporting lines to a geographic arrangement (e.g., health workers reported to district administrators, whose capacity to effectively oversee these workers varied across regions). A number of other issues are also attributed to the failure of the reforms, such as general confusion around functional responsibilities across levels of government as well as inadequate funding.

⁵ May, R. 2011. *Policy Making in Decentralization*. In May, R., 2011. *Policy Making and Implementation: Studies from Papua New Guinea*. Australian National University. Canberra.

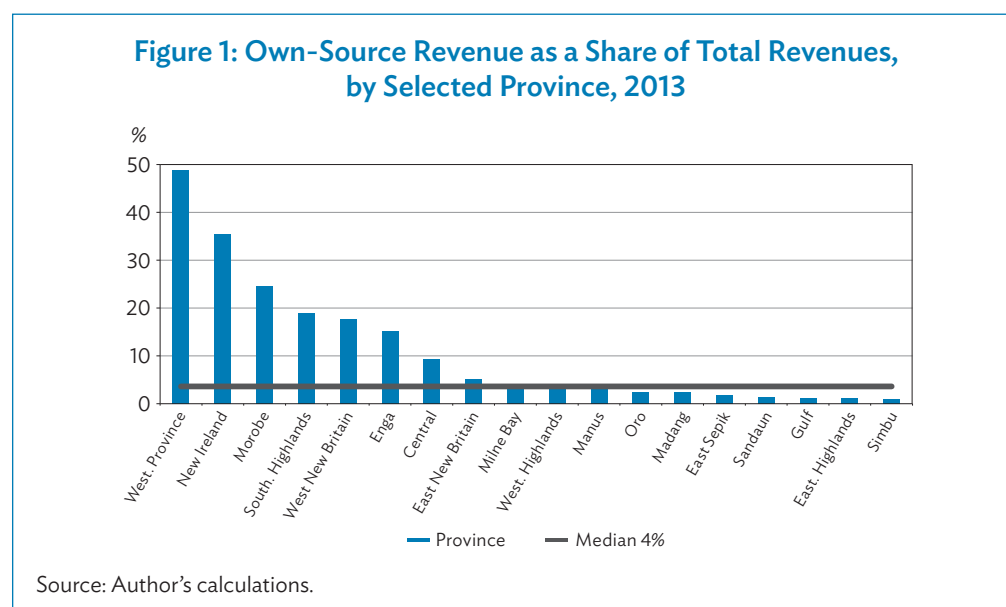
Subnational Financing Systems and Expenditure Trends

PNG's intergovernmental financing system is characterized by extreme vertical fiscal imbalance. Own-source revenue and resource royalties make up (at most) 49% of a province's annual revenues, with the median much lower at 4% (Figure 1). This also demonstrates the large differences in fiscal capacity between provinces, mostly driven by access to resource royalties.

Numerous funding streams are provided to each level of administration as well as ad-hoc national government infrastructure financing as part of the Public Investment Program. The main funding sources for subnational entities are own-source revenues, function grants, and Service Improvement Program (SIP) grants (Appendix 2).

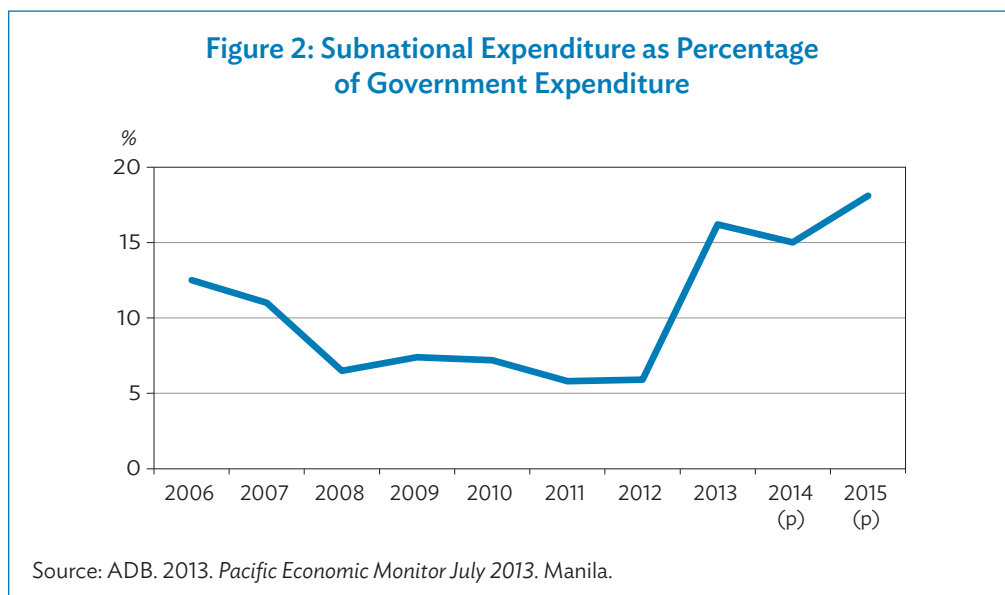
In 2005, NEFC undertook a number of studies to determine whether the level of fiscal resources available to provinces and local governments was sufficient given their expenditure responsibilities.⁶ This study found that most provinces and local governments were severely underfunded, impairing their ability to purchase the necessary inputs to deliver basic services.

In response, devolved funding to provincial governments experienced a rapid increase from 2007, as major reforms to intergovernmental financing were progressively introduced. Continued advocacy and negotiations by NEFC resulted in the introduction of a tax-sharing arrangement in 2009. The Intergovernmental Relations (Functions and Funding Act) created a revenue-sharing arrangement whereby the provinces were guaranteed 6.57% of

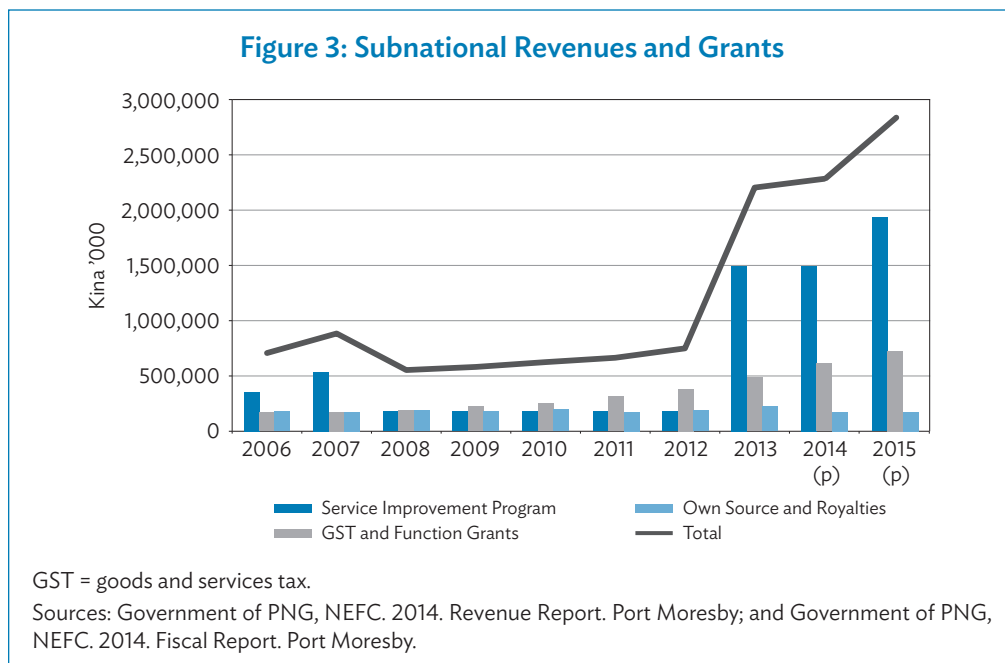


⁶ Supported by the Australian Department of Foreign Affairs and Trade technical advisors.

Funding to subnational governments has risen dramatically since 2012...



...driven largely by a large scaling-up of SIP grants.



national nonmining tax revenue. This new pool of funding was distributed using a horizontal fiscal equalization formula to improve the fiscal capacity of the poorest provinces. At the time, this tax-sharing arrangement was expected to slowly bring the fiscal capacity of all provinces to a level roughly in line with their expenditure responsibilities.

The strong growth in national taxation revenue from high economic growth coupled with high commodity prices enabled the government to dramatically increase the share of funding and goods and services tax collections going to provinces. By 2014, all provinces were funded at or above NEFC's minimum cost-of-services estimate.⁷ High worldwide prices for resources also increased some provinces' royalty revenues.

Notwithstanding this strong growth in own-source revenues and grants for recurrent expenditure, the increase in SIP grants has most dramatically changed the discretionary resources available to subnational entities. In 2013, SIP funding was increased to the provinces (K5 million per province, K445 million in total), districts (K10 million per district, K890 million in total), and local governments (K500,000 each, K160 million in total).⁸ Representative committees chaired by the governor (for provinces) or MPs (for districts) control the budget allocation and monitor the implementation of these grants. These grants were held constant in the 2014 budget, and announcements are for the program to increase to K15 million per district in 2015.

Historically, SIPs were used to finance projects that were considered too small for the national government to manage. In the late 1990s and early 2000s, the total amount of devolved funding was small (around K40 million per year).⁹ However, with their large growth since 2011, the expected role of devolved SIP grants have also grown. SIPs are now seen as a central feature of the government's drive to redress deteriorating minimum services delivery standards through reestablishment of basic infrastructure and facilities for essential services.¹⁰

From an equity perspective, the National Economic and Fiscal Commission (NEFC) has endorsed the concept of devolved block grants, as it found that they improved interprovincial equity and shifted spending decisions out of the national government down to local communities.¹¹

The SIP grants are untied, and are only required to be used to fund development projects. Data are not collected on the types of projects funded by a district SIP. However, anecdotally, a significant proportion of the funds are used on infrastructure (e.g., road rehabilitation and the construction of classrooms and medical centers). The SIP is popular among MPs, as it is a discretionary grant that gives them the financial resources to deliver on their local infrastructure priorities, often according to their own agendas and in disregard of 5-year development plans. The increase in funds has exacerbated this problem, with a number of infrastructure projects being out of alignment with province-wide services delivery plans, or recurrent budgeting allocations (set by the provincial executive councils). One common example is when open-electorate MPs fund the construction of a new

⁷ Author's estimate. Unpublished data provided by NEFC.

⁸ Footnote 31.

⁹ Government of PNG, NEFC. 2009. *Development Expenditure Review: Development Appropriations, 2003–2007*. Port Moresby.

¹⁰ Government of PNG, Department of Implementation and Rural Development. 2013. *PSIP, DSIP, LLGSIP Administrative Guidelines*. Port Moresby.

¹¹ Footnote 65.

medical center in his or her district, but the provincial government does not allocate a budget for staffing or recurrent expenditure, leaving the infrastructure unutilized.¹²

The rapid growth in subnational funding, particularly SIP, funding over the last few years has amplified a number of significant implementation challenges for subnational governments. In its 2013/14 audit of district expenditure, the Auditor-General's Office recommended that the SIP program be discontinued due to poor expenditure. A key finding was that over 26% of spending was on "projects where expenditure is unsupported or projects are incomplete/abandoned," 9% was on "non-[SIP]-related expenditure," and 13% was on "vehicles and heavy equipment with limited application towards [SIP] objectives."¹³

Poor implementation performance at subnational government levels actually follows a similar pattern at the national level. National government agencies underspent their capital budget allocations in 2013 by roughly 19% with more than half of the 2013 development allocations were spent in the fourth quarter, signaling a rush to deposit funds into project trust accounts before the end of the fiscal year.¹⁴ The inability to effectively translate higher spending allocations into actual infrastructure and services delivery reflects the significant capacity gaps that existing in the budgeting, project design and expenditure execution functions across all levels of government.

Subnational Expenditure Implementation Challenges

Planning and budgeting

The Fiscal Responsibility Act of 2005 details steps to make PNG's national budget preparation more orderly and transparent, and improves fiscal planning and expenditure management.¹⁵ The government has also developed national plans and fiscal and debt strategies. The Development Strategic Plan, 2010–2030 emphasizes advancing public sector reform, improving budget and financial management, providing accountable and transparent services delivery, and improving regulations and public service effectiveness.¹⁶

The Department of Treasury prepares budgets with reference to the larger national planning framework, fiscal and debt strategies, and priorities.¹⁷ The four "enabler" priority

¹² This may be due to the fact that the provincial government is unaware of the existence of the newly built infrastructure, or due to political disagreements about where to locate the infrastructure.

¹³ Auditor-General's Office of PNG. 2014. *District Services Improvement Program: A Report on the Key Findings Resulting from the 2012/2013 District Audits of Expenditure Relating to the District Services Improvement Program (DSIP)*. Port Moresby.

¹⁴ Footnote 9.

¹⁵ ADB. 2014. *Country Governance Risk Assessment and Risk Management Plan: Papua New Guinea*. Manila. Unpublished.

¹⁶ Government of PNG, Department of National Planning and Monitoring. 2010. *Papua New Guinea Development Strategic Plan, 2010–2030*. Port Moresby. pp.122–123, 140–148.

¹⁷ Government of PNG, Department of National Planning and Monitoring. 2014. *The National Strategy for Responsible Sustainable Development for PNG: A Paradigm Shift—Addendum to the Development Strategic Plan 2010–30*. Port Moresby.

sectors—health, education, infrastructure, law and order—now receive much higher allocations, although these allocations do not necessarily fund priority projects identified in these sector plans. At the subnational level, all provinces draft 5-year development plans and annual budgets within funding ceilings provided by the national government. The quality of budgets varies by province, and aligning service delivery plans with realistic cost estimates is challenging.

Expenditure execution

The large increases in budget allocations have demonstrated a misalignment between projects appearing in the budget and the government’s capacity to implement those projects. Agencies prepare projects and submit budget requests, but receive budgets with line items for different, typically unfamiliar, projects. Thus, budgets are misaligned with their requests, and new projects are not well developed and bear unrealistic cost estimates.¹⁸ This creates difficulties for infrastructure agencies when preparing the design work for large infrastructure, as they are expected to tender these unfamiliar projects within a fiscal year. Once a contract is tendered and awarded, other delays for variations, land disputes, or law and order problems often arise, and, as a result, costs frequently rise beyond original funding allocations.¹⁹ In short, indiscipline in the budget process slows implementation and raises costs.

This poor budget execution is demonstrated in the proportion of spending in the fourth quarter, which is high at both the national and subnational levels. In many instances, reports of spending in the fourth quarter are simply transfers of funds into project trust accounts. NEFC regularly states that late disbursement of grant funds to provinces is a major impediment to effective budget execution. Their recent Provincial Expenditure Review characterized slow cash release in terms of heart disease:

There are three major points of blockage and disease. The first is with the Department of Treasury, when it fails to pump money in a timely manner to a Province. The second is with the Department of Finance, through its Provincial Treasuries and District Treasuries, and whether they provide an efficient financial service at the sub-national level to Provincial Administrations and their District Administrations. And the third is with a Province, when it fails to make money available to the implementers of services – like schools, clinics, supervisory staff and extension teams.²⁰

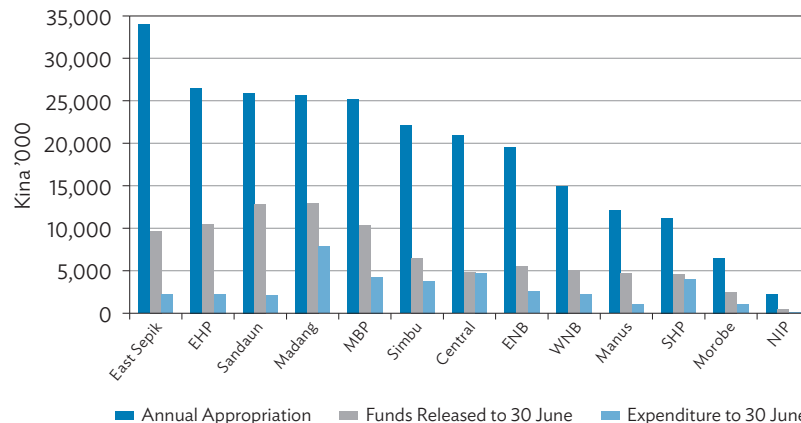
Cash flow for the SIP tends to be released in the first or second quarter due to the political nature of the funds. However, anecdotal evidence suggests that, in many cases, preparatory work on project scoping does not commence until funds are released, delaying project implementation. As the NEFC points out the bulk of function grants to Provinces tend to be released late in the year. However, analysis in 2013 of tied recurrent grants found that, on average, provinces had only expended 40% of their available cash balance by the end

¹⁸ Footnote 33.

¹⁹ Government of Australia, Department of Foreign Affairs and Trade. 2013. *PAJLP Law and Justice Infrastructure Impact Evaluation: Final Report*. Canberra.

²⁰ Government of PNG, NEFC. 2014. *Government, Money Arteries and Services: Provincial Expenditure Review 2012*. Port Moresby.

Figure 4: Warrant Release and Expenditure, Second Quarter 2013, Selected Provinces



Source: Government of PNG, NEFC. 2013. *2014 Budget Fiscal Report*. Port Moresby.

of the second quarter. This was a revealing finding, as the grants were tied to recurrent expenditure for activities that occur at regular intervals, are small in value, and are thus below tender limits. This indicates other capacity constraints also exist in budget execution at the subnational level.

Reporting

Many departments, subnational entities, and statutory authorities lack the capacity to maintain accounts and prepare reports on a timely basis. Further, when reports are not prepared, there is limited internal or external pressure to rectify the situation. In addition, numerous project reviews have shown that there is little follow-up on external audit recommendations.²¹ Reporting arrangements for the SIP only focus on acquittal of expenditure receipts to limit outright misappropriation. The Auditor-General's Office does not undertake performance audits of the SIP to ensure that the expenditure results in improved infrastructure on the ground.

Procurement

Procurement is a significant barrier to government effectiveness, as PNG's construction costs are high and rising quickly. The costs are three times those of other developing countries. The rise in construction costs is a function of increased demands from the mineral and other-resources extraction projects, reliance on imported construction inputs, and exchange-rate fluctuations.²² Long delays in procurement lead to greater cost

²¹ Footnotes 33 and 39.

²² See, for instance, ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loans for Additional Financing to Papua New Guinea for the Lae Port Development Project*. Manila. p. 3.

increases. Delays arising from contract negotiations, weather conditions, or conflicts within communities delay projects longer and raise costs.²³

In a 2011 assessment of procurement in the transport sector, consultants collected the private sector's perceptions of the procurement process. The private sector felt that government tender processes suffer from serious corruption, are prone to political influence, lack transparency, do not comply with the legal framework, and that the accountability institutions suffer from a lack of capacity.²⁴

The Public Financial Management Act (1995) and other laws provide a strong legal basis for sound public procurement, including the establishment of the Central Supply and Tenders Board (CSTB) to control and regulate procurement.²⁵ The CSTB created a set of standard bidding documents and a procurement manual in 2007–2009 to establish procedures and assist those responsible for procurement.²⁶ These standardized procedures, and more systematic evaluation, have helped reduce political interference in the procurement process.²⁷ However, the procurement process is still lengthy, approximately 400 calendar days from tender to award,²⁸ due to a number of challenges:

- (i) difficulties recruiting and retaining appropriately trained procurement specialists;²⁹
- (ii) no requirement to maintain proper procurement records (i.e., the legal statutes surrounding procurement require only the CSTB to maintain records from tender initiation to award);³⁰
- (iii) numerous approvals required at each step of the process that contribute to procurement delays and increase the opportunities for corruption;³¹
- (iv) splitting tenders into smaller lots to keep the value of the tender below the K300,000 public-tendering threshold, sidestepping CSTB processes and associated delays;
- (v) a high number of variations partly due to insufficient detail in design, and partly rushed scoping and project preparation; and³²
- (vi) supervision, monitoring, and contract management that all suffer from capacity constraints in both government agencies responsible for civil works, and the small number of private construction companies.

All subnational projects are identified and recommended by the joint provincial planning and budget priorities committees and the Boards of the District Development Authorities.

²³ See, for instance, Civil Works Capacity Constraints in ADB. 2010. *Country Partnership Strategy: Papua New Guinea, 2011–2015*. Manila.

²⁴ Charles Kendall & Partners. 2011. *Assessment of Government–Partner Procurement Capability and Capacity, and Associated Procurement Risk: Papua New Guinea–Australia Transport: Department of Works Final Assessment Report*. Port Moresby. pp.15–16.

²⁵ Government of Australia, Department of Foreign Affairs and Trade. 2013. *PAJLP Law and Justice Infrastructure Impact Evaluation: Final Report*. Canberra. p. 59.

²⁶ Government of PNG, Central Supply and Tenders Board. 2010. *PNG Procurement Assessment Report: Using the OECD–DAC Methodology for Assessing Procurement Systems*. Port Moresby. p. 4.

²⁷ World Bank. 2006. *Papua New Guinea Country Procurement Assessment Report*. Washington, DC. p. vii.

²⁸ ADB. 2014. *Papua New Guinea Tripartite Country Portfolio Review: Background Paper*. Manila. p. 9.

²⁹ Footnote 111, p. 62.

³⁰ Footnote 29.

³¹ Footnote 29.

³² Footnote 111, p. 63.

Both the committee and Boards can work in isolation, and the divided and overlapping responsibilities lead to frequent confusion and a lack of coherent planning and oversight. Technical skills at the district level are often insufficient to effectively plan, implement, and execute contracts, leading to severe deficiencies in delivery of outputs.³³

All subnational procurement above K300,000 and below K10 million must be approved by the Provincial Supply and Tenders Board³⁴ or (if in operation) the District Supply and Tenders Board.³⁵ The large increase in devolved funding comes at a time when some procurement boards are already struggling to process procurement requests in a timely manner, further exacerbating the bottleneck and impacting on effective project implementation.³⁶

These difficulties in procurement create perverse incentives to undertake projects that do not require the procurement of goods but may have low or narrow community benefits (e.g., providing tertiary scholarships rather than building additional primary school facilities), and small contracts that circumvent procurement rules but are inefficient and difficult to manage.

Remoteness

Rates of urbanization in PNG are very low by international standards, with only 13% of the population resides in urban areas. The degree of remoteness also varies dramatically across PNG. NEFC's PNG Accessibility/Remoteness Index indicates that extremely remote areas are between 4–6 times more geographically isolated than the country average.

Remoteness hampers service delivery efforts in rural areas in a number of different ways. It increases the costs of inputs to infrastructure projects and services delivery due to shipping via high-cost means (e.g., charter air freight, small boat, or four-wheel drive). Construction projects also have higher mobilization costs, as contractors either do not exist in the local area or do not have the capacity to undertake government projects, thereby requiring contractors from other areas to relocate to the project site. Limited communication means that local projects are not planned in a coordinated manner, and contracts are often small in value, limiting the type of contractors attracted to the work. Verification and quality control of projects are difficult due to information asymmetries and the disproportionately high cost to transport auditors and inspectors relative to the overall project value.

Recent Government Reform Strategies

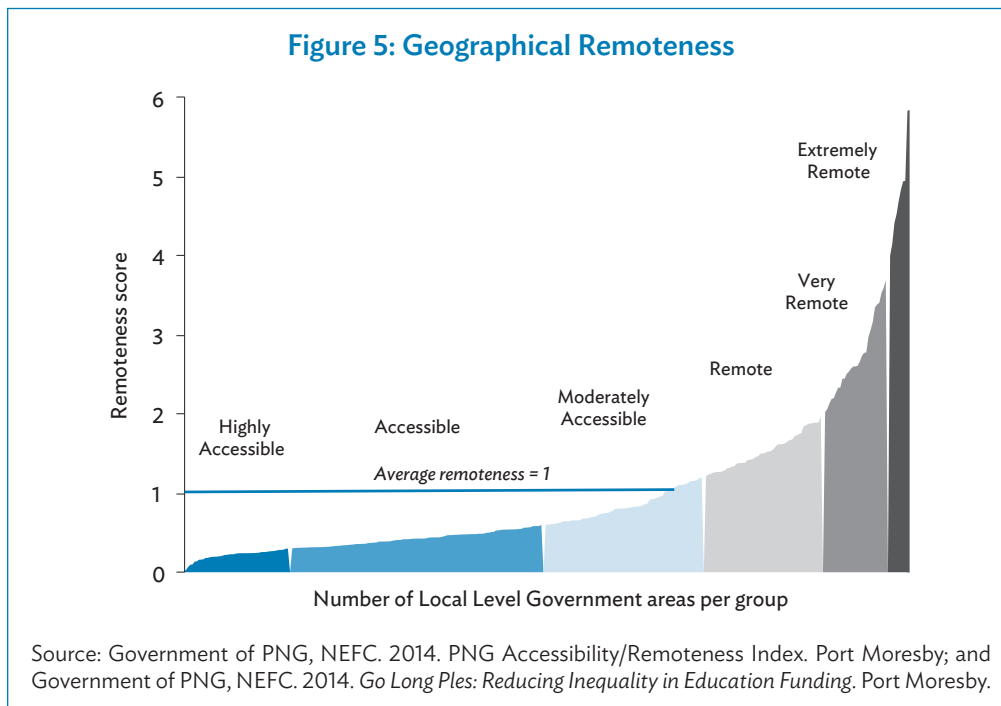
The government is deploying a number of strategies in an attempt to overcome these challenges. It is undertaking a public expenditure framework analysis assessment to identify and address unsatisfactory public financial management processes. It is devolving budget decision making to lower levels of government to improve accountability and reduce the

³³ Footnote 112.

³⁴ Footnote 91.

³⁵ Footnote 54.

³⁶ Footnote 112.



complexity of the national budget processes by devolving projects that are not of national significance to provinces and districts, and through the use of the SIP. A number of funding issues were resolved in 2009 thanks to NEFC subnational funding reforms that amended the Intergovernmental Relations (Functions and Funding) Act.

The main avenue of legislative reform during this current term of Parliament (i.e., 2012–2017) has been the District Development Authorities Act which formalized district administration into an authority of the national government, validating locally elected MPs' roles in overseeing administrative and services delivery functions at the district level—a shift from legislator to administrator. Before the reforms there was a disconnect between capital and recurrent expenditure, as the budget allocations powers were split between two entities at the district level (the district administration and the [now defunct] Joint District Planning and Budget Priorities Committee). The District Development Authorities Act merged these two entities as part of a broader effort to improve the effectiveness of rural service delivery.

Further, the national government is undertaking a review of the Organic Law of Provincial and Local Level Governments to improve clarity around functional responsibilities and roles of governors and provincial administrators.

ADB's Existing Partnerships with Subnational Governments

This section summarizes a number of stakeholder sessions held with ADB project officers and ADB Project Management Unit (PMU) team leaders. These sessions probed whether ongoing ADB projects had been approached by subnational entities to partner and, if so, the arrangements underpinning those partnerships.

Overall Findings

All projects reported a high degree of interest by subnational entities to provide counterpart funding. Furthermore, all implementing agencies were currently utilizing subnational funding to differing degrees. Some were well advanced in linking with subnational entities and were accepting counterpart funding into their project trust accounts. Others took an arm's-length approach.

Discussions also highlighted that the visibility of ADB projects is strong in PNG, aided by the stringent governance, social, and environmental safeguard policies of its projects.³⁷ For politicians, there are benefits with being associated with such projects, and counterpart funding is one viable way of partnering. The PNG Resident Mission provided a number of examples of open-electorate MPs proposing to provide counterpart funding. This indicates strong interest in subnational entities to partner, and a growing fiscal capacity for these partnerships to undertake projects that could provide a demonstrable benefit to local communities.

Project Specific Findings

Highlands Region Road Improvement Investment Program. Discussions with the PMU team leader in the Department of Works revealed that this project has historically accepted sizable amounts of subnational counterpart funding. It is estimated that around

³⁷ ADB projects are implemented using the government's systems, but several additional safeguards are included across the project cycle: feasibility and project preparation are undertaken using experts to ensure that the design and project costs are accurate; a dedicated ADB PMU manages the project, which is co-located with the implementing agency, provides capacity support to the delivery of the project, and often comprises national and international staff to act in in-line positions; several social protections are included at the design of each project as it is being implemented by the PMU; procurement processes are monitored by the PMU, and funds may be withheld where a tender is noncomplying; and additional quality assurance is provided through the use of external quality assurance contractors in the delivery of some projects.

K22 million had been received since 2007, mostly from district SIP grants. The funds were used to facilitate the implementation of the project, such as by paying compensation to landowners for access to land or destruction of crops; and for preparatory works, such as survey and design of local roads. The process of engagement was typically through a brief memorandum of understanding between the subnational entity and the department, outlining the agreed list of projects. The subnational counterpart contributions were transferred into the same project trust account, which is used to manage the national government counterpart contribution. Most procurement was below the threshold for tendering, and the PMU team leader (as the officer responsible for the project trust account) authorized the expenditure. Acquittal of receipts for all expenditures was provided to the subnational entity, and a 4% management fee was deducted to cover administration costs to the department. Currently, the project is managing a K2 million counterpart contribution from Dei District.

Rural Primary Health Services Delivery Project. The health sector PMU team leader expressed initial concerns over the lack of clarity for managing subnational counterpart contributions and thus did not accept them into the project trust account. However, it had received a number of requests from subnational entities to engage in various types of partnerships. The approach the health project took encouraged the subnational entity to use the funds to facilitate the ADB project. One example was where the subnational entity used the funds to undertake land surveys for project sites or purchase land. It also shared technical resources (e.g., architectural drawings of health centers and scoping documents) to assist subnational entities to develop additional facilities over and above the ADB project. Finally, it assisted subnational entities to develop service plans and guide the development of future infrastructure (either funded through the ADB project or other sources). These service plans also aimed to better integrate the hierarchy of services delivery.

Towns Electrification Investment Program and Port Moresby Grid Expansion Project. PNG Power Limited reported that it has been using subnational counterpart funding for a number of years through the towns electrification investment program. Under this program, subnational entities directly fund PNG Power Limited to install transmission and distribution infrastructure. PNG Power Limited has a team dedicated to working with subnational entities, which is separate from the PMU managing ADB projects.

Civil Aviation Development Investment Program. The PMU team leader outlined a number of small-scale interactions with subnational entities where there were common interests, such as removing unexploded ordinances and community-engagement programs. More recently, commitments have been made from several provinces to cofinance subprograms, such as the governor of West New Britain making commitments around the Hoskins Terminal Building. None of these major cofinancing initiatives have reached an implementation phase, so funding has not been drawn from subnational entities for the subprograms.

Pros and Cons of Informal versus Formal Subnational Partnerships

Given that subnational governments are already making substantial, albeit mostly informal, contributions to ongoing ADB financed projects, the study sought views on whether this informal approach is optimal, or if there could be benefits from a more formalized framework.

The existing informal approach was deemed to be suitable in an environment where subnational resources were limited and opportunities to partner were based on small, sporadic, counterpart contributions to existing projects. The advantage of this informal approach is that it is flexible and responsive to subnational entities and requires very little additional administrative effort. It is thus highly compatible with the limited capacity to prepare detailed budget plans at the subnational level and gives Provincial Governments and MP's a useful outlet for utilizing unspent funding allocations.

With the increased funds available at the subnational level there are now, however, emerging risks with these informal partnerships—along with greater opportunities. A lack of transparency and reporting on engagements with subnational entities creates risks that are currently managed by the PMU team leaders, but are not systematically tracked as part of project review missions or by the government. This creates a number of risks including the possibility of creating expectations that cannot be delivered upon or other misunderstandings between parties. Subnational entities may not appreciate that ADB staff and contractors rely on ADB Board approval for a number of decisions and do not have delegated powers or discretion to vary project scope. For example, if, after initial discussions with the PMU team leader, a subnational entity purchases land under an expectation that an ADB project will build infrastructure on the site, reputational and relationship challenges for ADB may occur if the project does not eventuate.

Adopting a more formal link between existing ADB financed implementation structures and the financial resources of subnational governments could thus provide a number of benefits. Firstly, by improving monitoring and oversight it would reduce the reputational risks associated with unplanned contributions. Secondly, by mobilizing additional subnational counterpart funding the impact of ADB financed investments could be enhanced.³⁸ At the same time ADB's financial and procurement oversight functions could be used to support a more effective utilization of this subnational funding. This may include for example:

- (i) **Reducing the perception and risks of corruption.** A perception of corruption potentially discourages some contractors to tender for work, reducing competition and increasing costs. A survey of private contractors found that they believe

³⁸ In the case of transport projects, for example, larger amount of subnational counterpart funding could be used to expand improvements to local feeder roads and other local connections. This would increase the potential catchment of users able to access the main roads and bridges being rehabilitated. In the case of electricity projects, using subnational funding to expand rural connections would increase generation demand and improve the return on fixed capital costs.

that tenders funded by development partners provide assurances of greater transparency and fairness.³⁹

- (ii) **Improving scoping and costing.** Due to lack of skilled staff, provinces and districts have historically had difficulties with adequately scoping projects, which then flows through to inaccurate project costing. By partnering with the national executing agency, they would have greater capacity to accurately scope and cost the projects.
- (iii) **Improving procurement and management of contractors.** Procuring national and local projects jointly would allow local projects to benefit from PMU oversight of the entire project. This provides a degree of assurance to subnational entities that they will receive value for money and quality construction.
- (iv) **Reducing project costs.** This would occur due to greater economies of scale (i.e., use of larger contractors) and sharing mobilization costs across national and local projects.
- (v) **Improve project delivery.** By leveraging national government agencies and ADB's capacity to manage contracts and use of third-party contractors to verify quality, project delivery could be improved.

Other Considerations

A further consideration that needs to be taken is one of the compliance burden on subnational entities and timing. The culture of politics in PNG, and the challenges faced with poor implementation capacity, places a premium on the ability of politicians to demonstrate immediate development activity to their constituents. As a result, partnerships that require lengthy administrative processes to accept counterpart funding are unlikely to be successful in most cases. Similarly, because of capacity constraints within subnational entities, onerous preparatory documentation will reduce the attractiveness of engaging in partnerships. This is not to say that financial management safeguards should be lowered to allow subnational counterpart funding, but the administrative burden of engaging in partnerships will be a key barrier if they are onerous.

Practical subnational entities should continue to manage their own funds to acquire project inputs. However, in a number of cases, such as for joint projects where national and local infrastructure is procured as a single contract, funds need to be committed and managed by the PMU. It is recommended that subnational counterpart contributions be managed by national government implementing agencies, as this keeps the funds within the public financial management framework and reduces the administrative burden of ADB accepting funds. Project officers expressed concern that processes for ADB to accept and manage subnational counterpart funds directly could be onerous. Many pointed out that it would be treated in a similar manner to grant funding provided by other donors that requires ADB Board approval before it can be accepted.

An alternative approach is to treat the funds in the same way as national counterpart funding, which is managed by the PMUs in a government project trust account. Subnational counterpart funding would be transferred into the project trust account used to manage

³⁹ Footnote 110, pp. 15–16.

the national government's counterpart funding (possibly into a subaccount). This would maintain consistency between national and subnational counterpart funds—all government funds would remain managed through government systems—and avoid unnecessary processes from ADB taking custody of the funds. It should be noted that ADB would continue to provide oversight of the funds through the PMUs and the project review processes. PNG's public financial management rules and regulations do not restrict the ability of subnational entities to provide counterpart funding to development projects.

Handling subnational counterpart funding in the same way as national counterpart funding is in line with the Public Finances (Management) Act. Funds would be deposited into project trust accounts and managed by the implementing agency. The implementing agency's section 32 officer (i.e., an officer in a government department who has the power to authorize expenditure) would handle the funds in the same way as other departmental funds, thereby satisfying the Public (Finances) Management Act.

Considerations for Establishing Formal Local Infrastructure Partnerships

Key Principles

Local infrastructure partnerships describe a range of arrangements where subnational government entities provide a counterpart contribution to enhance an existing ADB project, or in exchange for additions to the project scope to include local infrastructure. It also refers to arrangements whereby PMUs provide support or share technical materials to subnational entities to assist them in delivering local infrastructure projects.

These partnerships aim to maximize the impact and usefulness of ADB assistance in PNG by providing opportunities for subnational entities to use their rapidly growing fund availability more effectively and more efficiently. PMUs will play a central role in these activities, with discussions with PMU team leaders indicating a strong desire to better utilize subnational counterpart contributions in their projects, given the potential benefits and limited expected additional work involved.

By their very nature, local infrastructure partnerships are opportunistic and can only occur where synergy exists between the ADB financed projects and the subnational government's expenditure priorities. It is not envisioned that ADB would engage in partnerships that were not already part of ADB's portfolio of activities agreed at national government level with central government agencies and relevant line ministries. This is necessary to remove any potential for the scope of ADB supported activities to expand outside of the boundaries of the ADB-PNG Country Partnership Strategy, 2016-2020, and to limit the additional administrative burden on PMUs. Other key principles that should be considered in the design of local infrastructure partnerships include:

- **Only engage when synergies between the main ADB and subnational project exist.** Local infrastructure partnerships should only be undertaken when there are synergies between the main ADB project and the local infrastructure project. These synergies may be due to geographical proximity, technical requirements between projects where design or other costs can be shared, or some other linking factor. Ensuring synergies exist improves the likelihood that administrative burden on PMU staff and contractors is minimized, and the benefits of partnering are maximized.
- **Maximize social benefits while being responsive to local priorities.** A balance is needed between being responsive to local priorities and promoting partnership options that maximize social benefits. Opportunities for local infrastructure partnerships should be included early in the scoping stage after an initial fact-

finding mission. This provides an opportunity to assess their potential social benefits and develop the partnership into a comprehensive package that can then be presented to subnational entities.

- **Minimize administrative burden on subnational entities.** Subnational entities have limited capacity to develop lengthy project bid documents, respond to technical requests, or navigate through complex agreements. Consideration of these limitations should be factored into any partnerships.
- **Recognize the impact of the political cycle on project timing.** Politicians in PNG have a high turnover rate, with over 50% only serving one political term. As such, projects that have time spans over two electoral periods will be less enticing to them. Long-term commitments may also be difficult to manage, as newly elected politicians will have an incentive to disown their predecessors' infrastructure priorities. The next election in PNG occurs in 2017. This provides an opportunity to test the local infrastructure partnership model with some smaller-scale engagements before the election. As part of the scoping for new projects, ADB should start to identify opportunities for local infrastructure projects that could commence in early 2018.

Integrating Subnational Partnerships into the Project Cycle

Partnerships would likely be formed at two points in the ADB project life cycle: at the preparation and appraisal stage; or later at the implementation stage when contractors have been engaged. This study refers to these two points of engagement as the proactive approach and the opportunistic approach. It should be noted that each approach is not mutually exclusive. Ideally, a proactive approach focuses on the larger and/or technically challenging local infrastructure projects, with smaller-scale projects being included opportunistically.

Proactive Approach

The proactive approach would occur early in the project lifecycle when potential add-on local infrastructure components are presented as part of consultation with subnational governments during the initial fact-finding mission. The project scope includes provisions for local infrastructure projects to allow flexibility to further engage with subnational governments.

The benefit of the proactive approach is that it allows time to design local infrastructure projects with a full consideration of the options and for subnational entities to approve the project through their budget committees. However, the time between the preparation phase and the implementation phase (normally 1–2 years) may be too long for some politicians to commit, as they are under pressure to demonstrate immediate progress.

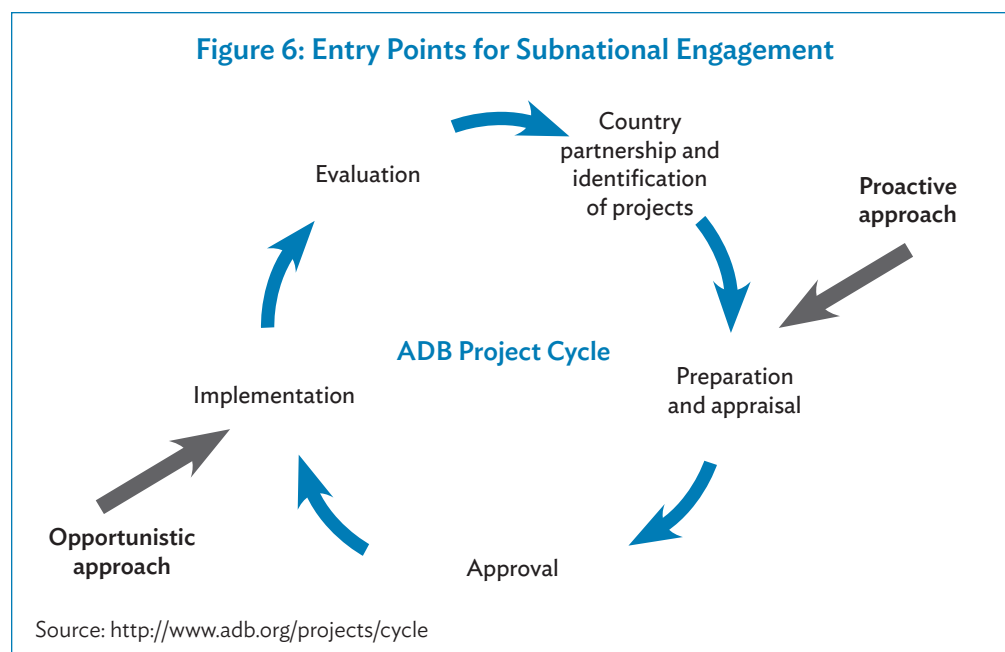
Feedback from ADB project managers and PMU staff highlighted the importance of building flexibility into the scope of loan agreements to engage in local infrastructure partnerships. Such flexibility then allows for PMU leaders to undertake opportunistic engagements without submitting a project scope variation.

The proactive approach aims to build the subnational scope of work into the project design from as early a stage as possible, maximizing the opportunity to achieve synergies in design, tendering, and construction. Earlier engagement also allows ADB to consider the scope of work within its social protection framework and ensure that it is aligned to broader government service plans.

Opportunistic Approach

The opportunistic approach would occur at a later stage in the project cycle when subnational governments are approached once the contractor has been engaged. Any local infrastructure project is implemented by the contractor through a contract variation.

The shorter time frame is more attractive to local politicians because of their ability to demonstrate immediate activity. However, the shorter time frame may require subnational entities to make a midyear budget variation. Similarly, if the local infrastructure project is outside the scope of the existing project, ADB may need to seek Board approval for a change of scope.



Role of the Project Management Unit

Partnerships are about providing capacity support in a way that is sympathetic to the informal approach of PNG's subnational entities and recognizes that key decision makers value interpersonal relationships with development partners. This necessitates an on-the-ground focus that can only be provided by PMUs.

The key tasks and support are at the project delivery level, which reinforces the importance of the PMUs. PMUs must identify opportunities to partner by understanding the local infrastructure priorities and engaging with key decision makers, facilitate the partnership agreements between the implementing agencies and subnational entities, and support the implementation of the local infrastructure project either directly or by providing advice or sharing information.

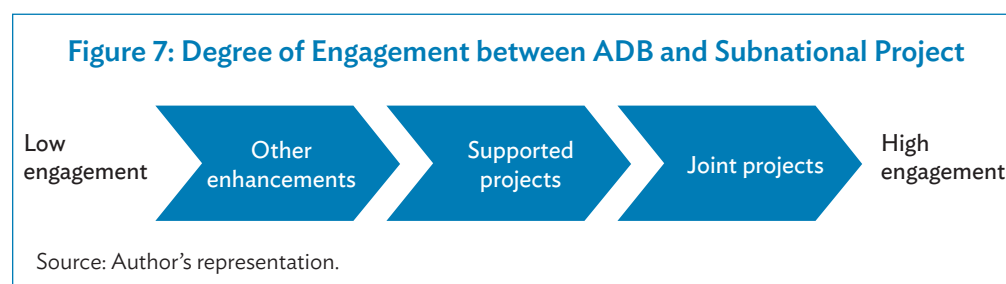
It is important to note that each step in developing the partnerships with subnational entities will require active support by PMUs. Requirements on subnational entities to provide extensive proposal documents or dedicate key personnel will be a deterrent given their lack of capacity (particularly at the district level and below). Subnational entities are already overwhelmed trying to deliver projects and services, and local infrastructure partnerships are about providing a way to relieve some of the burden by providing an alternate project delivery mechanism. As such, it is recommended that the ADB fact-finding missions and PMUs take an active approach to working with subnational entities.

Role of the Resident Mission

The PNG Resident Mission's would have a crucial role to manage the risks and ensure coordination among all local infrastructure partnerships. The resident mission would need to be informed of all proposed partnerships and have input into whether they are fully aligned to the ADB-PNG Country Partnership Strategy, 2016-2020 and ADB priorities more broadly. This ensures that all commitments can be honored and that ADB does not inadvertently become embroiled in internal PNG politics. There is also an important leadership role for the PNG Resident Mission in advocating for greater engagement with subnational entities and utilization of counterpart funding. The task facing the PNG Resident Mission is in improving the transparency of these types of engagements and advocating for partnerships that have significant social benefits.

Proposed Framework for Engaging in Local Infrastructure Partnerships

Three different models of local infrastructure partnerships (i.e., joint projects, supported projects, and other enhancements) are envisioned to represent different degrees of engagement. The model representing the highest degree of engagement involves the implementing agency taking responsibility to implement the project with funding provided by the subnational entity. At the opposite end of the spectrum, there may be opportunities for subnational counterpart funds to be used on enhancements to ADB-financed projects, such as the purchase of the construction site.



Joint Project Model

In the joint project model, the local infrastructure project is bundled together with the main ADB project. Design, scoping, procurement, and civil works are undertaken as a single project.

The benefits of a joint project model are that an integrated design can be developed that addresses the deficits across the hierarchy of infrastructure from the local to national level, thereby maximizing the benefits of the infrastructure.

Land transport is an ideal sector to undertake a series of joint projects because additional feeder roads could be designed in a way that maximizes the social benefits of the road network. The additional work would be built into the scope for a single procurement. The procurement would be sufficiently large that it goes to international tender and minimizes opportunities for corruption. Scoping the local infrastructure project up front would allow the contractor to design its work program in a way that minimizes costs and avoids a scope and contract variation later in the project.

Box 1: Hypothetical Local Infrastructure Partnership, Joint Project Model

A K20 million ADB-financed road rehabilitation project for a national highway in a highlands province is being implemented by the Department of Works through Contractor XYZ. The provincial government commits an additional K2 million from their Services Improvement Program funds for the grading of local feeder roads that connect to the highway. These feeder roads improve the transport connections for rural communities allowing them access to the highway so that they can transport vegetables to markets and access social services.

XYZ is selected through a competitive tender through the Central Supply and Tenders Board. Because XYZ is selected through a competitive tender, the province does not need to undertake a separate procurement process for the local road works. The local road grading project is included in XYZ's contract as a project variation.

The province contributes K2 million to the project trust account prior to commencement of work. The trust account is overseen by the ADB project management unit in the Department of Works.

Contractor XYZ incorporates the local road grading into its project plans to deliver both the national highway rehabilitation and local road grading in the most cost- and time-effective manner. Another contractor, ABC, is engaged by Department of Works to oversee the quality of work undertaken by XYZ.

Contractor ABC certifies the quality of the local road grading along with the national highway rehabilitation.

Receipts of the expenditure are provided to the province by the project management unit for acquittal purposes.

Source: Authors.

The main consideration for any politician when engaging in a local infrastructure partnership will be the time between committing funds and the commencement of civil works. The high turnover of MPs every election means that politicians will be reluctant to commit funds to a project that will be implemented after an upcoming election. Similarly, it is expected that MPs would be reluctant to commit funds to a project that could be up to 2 years in the future.

However, where nationally funded projects are focused into a condensed geographic area over the medium to long term, there will be familiarity with ADB as a development partner, greater confidence in the likelihood the project will go ahead, and an opportunity for the PMU leadership to develop strong professional relationships with the key stakeholders and build trust.

Partnership Structure

Formally, the joint project would be a local infrastructure partnership between the implementing agency and a subnational entity. The implementing agency would take

responsibility for the delivery of the local infrastructure project. ADB would assist in project identification, design, and scoping tasks for local infrastructure projects; financing the national infrastructure project; facilitating the partnership between the subnational administrations and implementing agency; and oversight and capacity support to the implementing agency's activities through the PMU.

To formalize the partnership and clarify each party's responsibilities, the provincial or district administration would enter into a memorandum of agreement with the implementing agency. The memorandum would include details on scope of work for local infrastructure project; details on estimated costs for local infrastructure project; agreement that the local project and main ADB project will be managed jointly by the implementing agency, which will be responsible for obtaining the Authority to Pre-Commit Expenditure and procuring a contractor to build both the local infrastructure and national infrastructure in line with procurement guidelines (i.e., through CSTB); agreement that the subnational entity will be responsible for funding the local infrastructure along with provisions around which party bears cost overruns and contract variations; and governance around management of project funds for the local infrastructure component. ADB would not be a party to the agreement, but would support the implementing agency and provincial or district administration through the PMU.

Role of the Project Management Unit

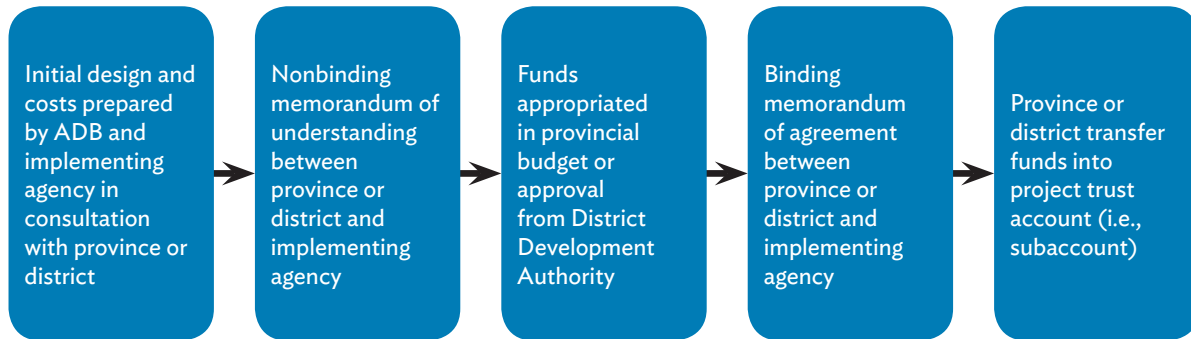
The PMU's function under the joint project would be to support the implementing agency in delivering the local infrastructure project as a component of the main ADB project. Ideally, the local infrastructure project would be included in the project scope early, and an integrated design put to tender. The memorandum of agreement developed by the PMU would outline which parties bore various risks. The PMU would report back to the subnational entity on progress.

Financial Management

The subnational entity would appropriate funds for the project as part of its annual budget process on the basis of initial costs outlined in a memorandum of understanding (i.e., a nonbinding precursor to the memorandum of agreement).

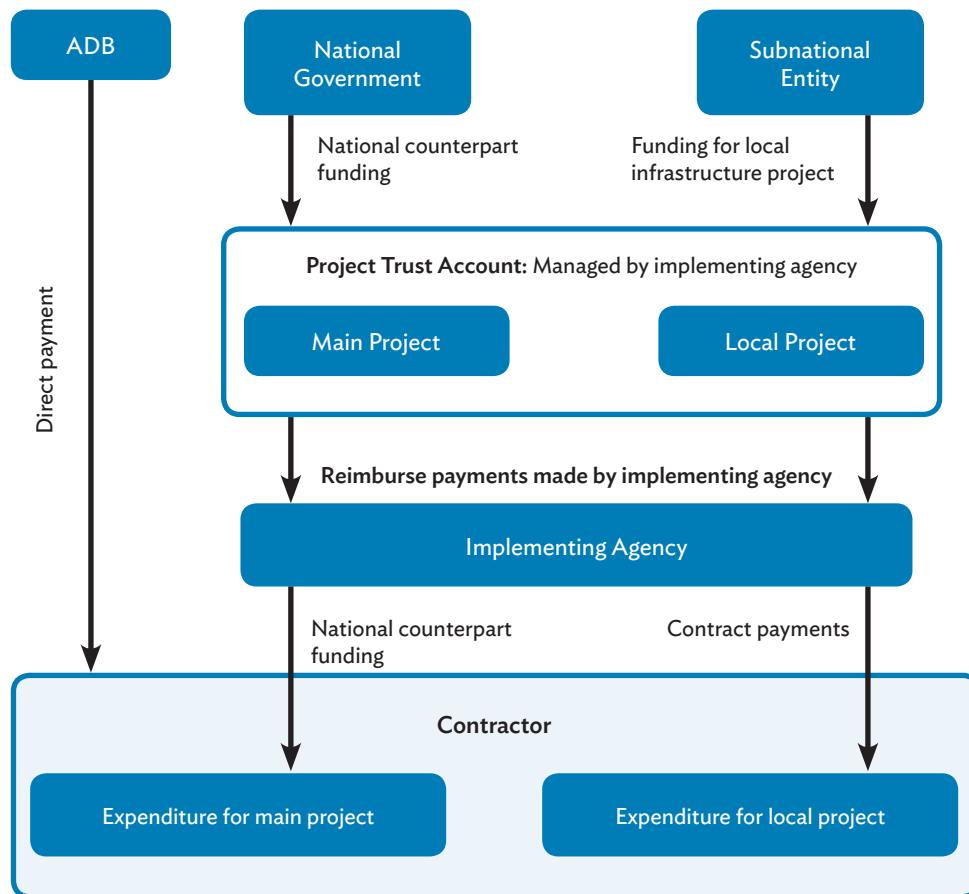
Financial management would continue to be governed by the Public Finances (Management) Act. Typically, the national government would provide counterpart funding, which is held in a project trust account managed by the implementing agency. Funding from the provincial or district administrations would be transferred into the project trust account managed by the implementing agency. A separate subaccount for the local infrastructure project could hold the funds for the local infrastructure project. The implementing agency would make payment to the contractor through their existing departmental accounts and be reimbursed by the project trust account.

Figure 8: Processes to Engage in Local Infrastructure Partnership



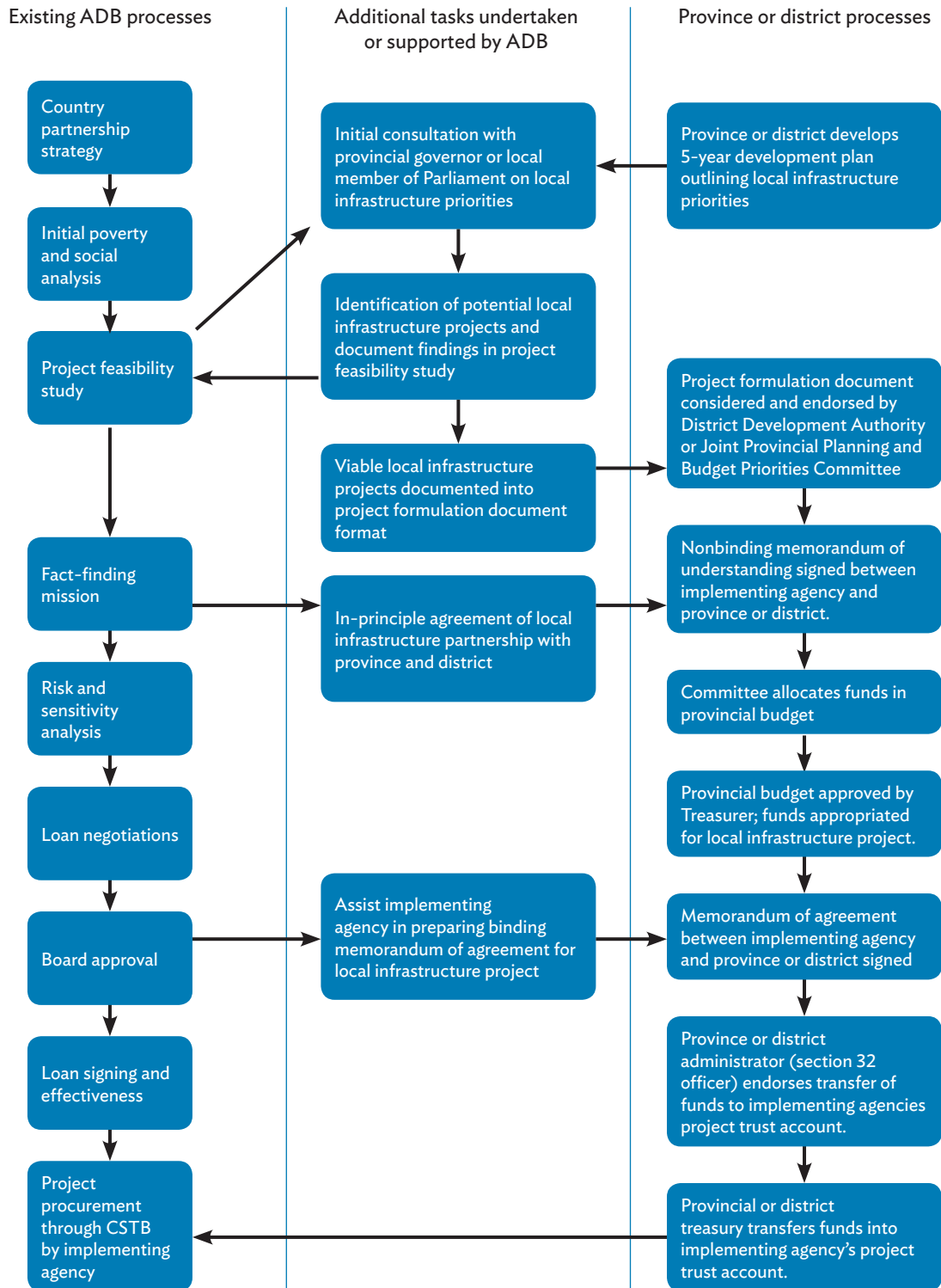
Source: Author's representation.

Figure 9: Funds-Flow Diagram



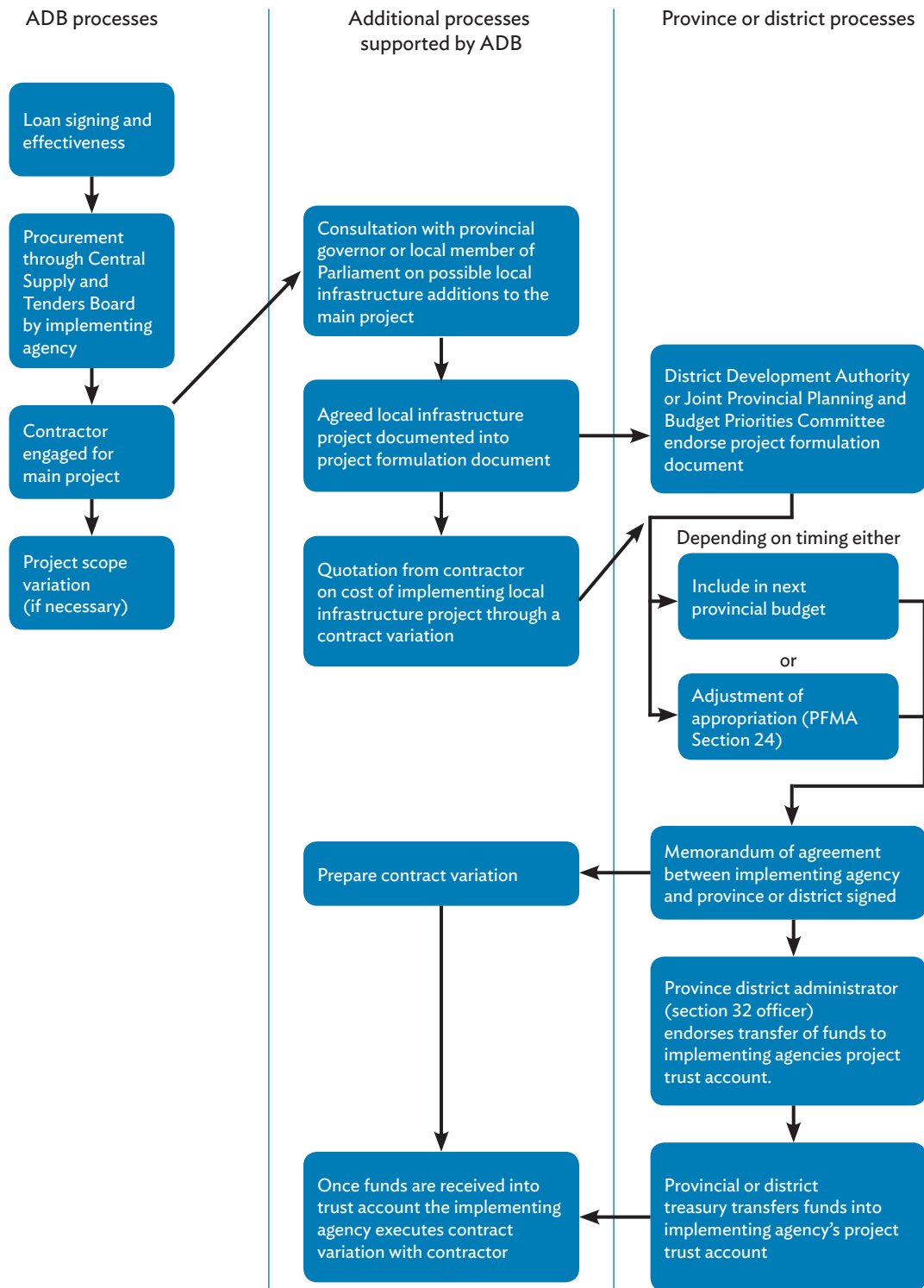
Source: Author's representation.

Figure 10: Proactive Approach for a Joint Project



Source: Author's representation.

Figure 11: Opportunistic Approach for a Joint Project



Source: Author's representation.

Risks and Other Considerations

Under the joint project model, the implementing agency would take responsibility for the implementation of the local infrastructure project. This adds risk to the implementing agency and may affect the capacity of the PMU to deliver the main ADB financed project.

As a rule, no local infrastructure partnership should be entered into if there is a risk it will significantly reduce the ability of the PMU to deliver on the core ADB-financed project. Consideration therefore needs to be taken to the most effective scale for a local infrastructure project relative to the added administrative burden on the PMU.

Local infrastructure projects that are large relative to the main ADB-financed project could materially reduce the capacity of the PMU. For these larger projects, formal analysis should be undertaken to ensure that there are material benefits from engaging in a joint project.

Smaller-scale projects or ones with limited social benefits should only be undertaken if they can be incorporated into the project scope with minimal additional effort. Similarly, if complex implementation issues also exist (e.g., lengthy negotiations with landowners), the projects may not prove to be justified unless additional implementation capacity can be added into the project design. This would, however, likely lead to extended delays in the processing and implementation of the original project, which may not be desirable for either ADB or the government.

The political volatility and poor financial controls at the subnational level raise material risks around nonpayment. To manage this risk, civil works on local infrastructure projects should not commence until funds have been transferred by the subnational entity in full to the trust account of the implementing agency.

Differences between ADB representatives and subnational government officers will include culture, education, and possibly language. Subnational government officers may be unfamiliar with ADB processes. This runs the risk that communication barriers will create unfounded expectations among participants. Any preliminary stakeholder discussions with subnational entities should take care to emphasize that any proposed local infrastructure projects may be subject to ADB Board approval and cannot be guaranteed.

Supported Projects

Where a national ADB-financed project is active in a province or district, the PMU would support the subnational entity to implement its project(s) by providing technical support and sharing any relevant documentation (e.g., architectural designs). Procurement would be through the Provincial Supply and Tenders Board as a stand-alone project but would be supported by the PMU.

Smaller projects that are procured through Provincial Supply and Tenders Board and are geographically dispersed provide less potential benefits from integrated service planning or economies of scale in the procurement and construction phases. However, on the basis

Box 2: Hypothetical Supported Project

An ADB-financed health project is building four community health centers, one in four different districts. In one of those districts, the local member of Parliament has committed to building three new health centers and rehabilitating the district hospital, but is having difficulties implementing the project. He approaches ADB to help get the projects on track.

The project management unit assesses the proposed locations of the health centers and offers advice on whether these are in line with the Provincial Health Authority's service plans. They share the architectural design and other scoping documents from the ADB-financed project with the district works unit. They then support the works unit by providing advice and vetting technical documents.

The district works unit manages the tender through District or Provincial Supply and Tender Board. The contractor building the ADB-financed community health centers is the cheapest tenderer, as they are familiar with the design and already have their equipment mobilized in the area.

The district works unit seeks advice from the PMU for any major contract variations, and they also provide advice on certifying contract completion.

Source: Authors.

of the technical capabilities of the PMU, there may still be benefits from entering into local infrastructure partnerships due to technical assistance to a subnational entity through supporting the scoping, design, tendering, and contract management of the procurement process provides capacity support; and reduced mobilization costs. The contractor who is already mobilized to a region would not need to mobilize plants and equipment.

This approach recognizes that there will be a limited prior engagement between the project and the open-electorate MP or provincial government, and as such, the relationship will be more transactional. Because the project is geographically dispersed, there will likely be limited prior engagement with stakeholders and knowledge of the conditions on the ground before the implementation phase. The supported project model relies on the PMU leader to identify opportunities and undertake dialogue with local decision makers as part of their activities.

Partnership Structure

Under this model, the implementing agency and PMU would not take responsibility for the project, but provide support and technical materials to the subnational entity to improve its capacity to deliver the project. No formal responsibility over the project is transferred to the implementing agency.

Role of the Project Management Unit

PMUs would be responsible for building relationships with subnational entities in the geographic region of their projects as a matter of course. Using these relationships, the PMU would identify whether project resources could be used by subnational entities to improve their project implementation capacity.

The PMU would share these resources and support the subnational entity to understand any shared material and the procurement and contract management processes (if necessary). The PMU's role would be akin to a mentor for the subnational project officers who could seek their advice on technically complex issues. As such, it would be important that the PMUs build relationships at the officer level within the organization for supported projects.

Financial Management

Financial management for the local infrastructure project would remain with the subnational entity. No transfer of funds to the implementing agency would occur.

Other Enhancements

The third model encompasses the range of other engagements among ADB, implementing agencies, and subnational entities. There are numerous configurations that could be taken, but the most common engagement would be where subnational entities commit counterpart funding to improve the likelihood of a project site being selected by ADB. For example, a subnational entity could commit to securing land, compensating landowners to guarantee access by contractors, or providing funding for future maintenance to be included into a contract.

Recommended Next Steps

Stock-Take and Risk Management

Objective. Improve transparency of ongoing engagements between ADB and subnational government entities.

Means. A stock-take of existing subnational counterpart contributions or parallel funding arrangements across the PNG loan portfolio should be undertaken as part of the 6-month country portfolio review mission. Where an informal arrangement exists between the PMU and a subnational entity, the review should undertake a risk assessment to determine the capacity of the PMU to deliver core responsibilities and likely administrative burden of the informal partnership, whether synergies exist between the national and subnational projects, and opportunities to add additional value to the partnership. The results of this stock-take and risk assessment should be summarized in the country portfolio review mission and provided to the country director of the PNG Resident Mission.

During discussions, it could be made clear that new proposals for engagements with subnational entities should be reported by PMUs to PNG Resident Mission and ADB Headquarters-based project officers.

Communication and Leadership

Objective. Improve consistency of processes for engaging in local infrastructure partnerships across ADB projects.

Means. The PNG Resident Mission should work in collaboration with project officers to play a coordinating and active risk management role. The PNG Resident Mission should provide guidance to PMUs and ADB Headquarters-based project officers on the framework for engaging with subnational entities. Agreement for any new local infrastructure partnerships should be captured within mission memoranda of understandings and be undertaken with the full knowledge of project officers and the PNG Resident Mission.

Over the medium term, the PNG Resident Mission may work to negotiate with Department of Treasury and Department of Finance around processes for accepting subnational counterpart contributions. Ideally, finance instructions from the Department of Finance would be released to provinces and districts on the processes around entering into funding partnerships with donors. ADB technical assistance to the Department of Finance on the drafting of these instructions may be useful to progress this task.

Pilot and Review

Objective. Increase ADB's experience in undertaking local infrastructure partnerships, test the partnership processes in a controlled manner, and review and enhance these processes.

Means. Two small-scale local infrastructure partnerships should be piloted, potentially with a joint project in the transport sector and a supported project in the health sector. The performance of these pilots should be evaluated and the framework refined if necessary.

Systematization

Objective. Local infrastructure partnerships become a routine part of ADB operations in PNG.

Means. For new projects, consideration of opportunities to partner with subnational entities should be included in the project-scoping stage. Fact-finding missions should be proactive in engaging with subnational entities to identify any local infrastructure priorities and potential funding sources. Evaluation of project proposals should include assessment of options for jointly tendered projects, with a focus on projects to commence after the 2017 parliamentary election. Proposals should be presented to relevant subnational entities in 2018.

The PNG Resident Mission should continue to work with PMUs to support the identification of opportunities for opportunistic engagements and supported projects.

APPENDIX 1

Subnational Service Delivery Responsibilities in PNG

At the national level, government has strengthened its mandate to provide guidance on the functional responsibilities of various levels of government. However, this guidance is contained in several different documents and legislation, and remains at times contradictory (Table A1). Key distinctions also need to be made between recurrent versus development responsibilities.

The power to determine the responsibilities of recurrent service delivery and administrative functions is vested in the minister for intergovernmental relations through the Intergovernmental Relations (Functions and Funding) Act 2009. It provides the power for the national government to take over a province's functions if it is failing in delivering its functional responsibilities, although this power has not been exercised to date.

Responsibilities are described in detail in the 2009 Determination of Service Delivery Responsibilities, published by the Provincial and Local-Level Service Monitoring Authority (PLLSMA). Generally, functional responsibilities for a sector are divided between each level of government rather than responsibility being vested in a single level. Of particular note is the overriding power of the national government to undertake any activity irrespective of whether it is already allocated to a subnational level of government.

Yet implementation of this legislation is also heavily impacted by the relationships between stakeholders and the availability of financial resources. Successful administration is dependent on an ability to navigate the entire devolved system. For example, a development project may involve a number of different levels of government, particularly regarding funding that may come from a range of areas. One senior executive at the Department of Works described it in the following manner:

Members [open electorate members of Parliament or representatives] may give [the Department of Works] some money from their [SIP] to do the land survey and build up a business case [for a new road], then they take it to [the Department of Planning and Treasury to be funded through PIP [the national government Public Investment Program].

In practice, most key services delivery activities are undertaken at the district level. This is partly due to geographical remoteness, reducing the ability of the province to effectively provide a presence in these areas, and partly due to the lack of capacity at the local level to undertake functional responsibilities. For example, most rural health and education patrols are undertaken by district staff, and maintenance expenditure is coordinated at the district level.

Table A1: Selected Functional Responsibilities between Provinces and LLGs

Category	Provinces	Local Level Government
New schools	Approve new schools, amalgamations of existing schools, school reopenings, changes of school names, closure of schools, transfer of schools, and changes in status.	Draw up plans for the establishment and development of new schools.
School infrastructure	Prepare annual maintenance plans, and inspect the condition and maintain provincial secondary schools, vocational and trade training schools, teacher and education worker housing, and ancillary facilities.	Inspect the condition of and maintain primary schools and its teacher housing and ancillary facilities.
Health infrastructure	Maintain health centers, rural hospitals, staff housing, and ancillary facilities where the health facility is unable to undertake the work from internal revenue.	Maintain aid posts and health worker housing.
Medical equipment	Maintain and arrange for the repair of rural health facility medical equipment; maintain adequate stocks of consumables, spare parts, and accessories for equipment in rural health facilities; pay for transport to and from the place of repair for equipment in rural health facilities that must be repaired away from the province; distribute equipment purchased and provided by the national government and/or donors to rural health facilities; fund the cost of health radio repairs; and identify radios that are not working and transport to and from Port Moresby for repairs.	Maintain aid post medical equipment.
Land transport	Develop, implement, and monitor the implementation of provincial transport policies and the provincial transport plan; implement and monitor the implementation of national transport policies and the national transport plan; collect, maintain, and analyze data on transport; maintain roads and bridges that are not classified as a national government responsibility; and promote road safety.	Certify village passenger motor vehicles, and maintain footpaths.
Sea transport	Register small craft; appoint inspectors to inspect small craft to see if craft meets minimum standards; investigate the condition of wharfs and jetties not under national government management; and maintain wharfs, jetties, and boat landings not maintained by national agencies.	No assigned function or responsibility.
Air transport	Maintain rural airstrips.	
Government buildings	Provide secretariat, logistical, and technical support to the Provincial Building Board; plan, survey, design, and cost public building projects; maintain provincial government buildings such as district administration buildings and staff housing; and inspect buildings to ensure that they comply with regulations.	Maintain local government offices and staff housing.
Other infrastructure	Install and maintain power to provincial headquarters and district administrations—solar, hydro or diesel-powered generators, including fuel, replacement, and maintenance.	Operate and maintain street lighting, and operate and maintain town water supply and sewerage where not provided by Eda Ranu or provincial government.

As districts are not specifically recognized in the Constitution as a level of government, unlike the provinces, they do not have an assembly or the power to make laws.¹ The introduction of DDA legislation in 2014 has however significantly strengthened their legal status.² The local member of Parliament (MP) is considered a district's representative to the National Parliament and chairs the board of the District Development Authority. From this position the MP exerts considerable influence over internal district administrative matters.

Administration and Control of Subnational Governments

Provincial assemblies. Provincial assemblies were established under §10 of the Organic Law of Provincial and Local Level Governments and compose

- (i) the provincial governor, who is the chair of the Provincial Assembly and chair of the Provincial Executive Council;³
- (ii) all MPs representing electorates in the province;
- (iii) one female representative nominated by the Provincial Council of Women;
- (iv) three persons appointed by the Provincial Assembly (in most provinces, the governor controls the selection of the three persons appointed by the Provincial Assembly, which gives them majority control over the assembly); and
- (v) if there is an existing and functioning paramount chieftaincy in the province concerned, not more than three tribal leaders.

The Organic Law of Provincial and Local Level Governments, §16A allows provincial assemblies to create any number of committees considered necessary to carry out their functions, roles, and responsibilities. The practice has been to mirror a number of ministries of the national government, and allocate functional responsibilities in areas such as finance, education, health, community development, business development, agriculture, and fisheries to these committees. The governor, using his or her majority in the Provincial Assembly, often appoints allies as chairs of these committees. These chairs then constitute the Provincial Executive Council, with the governor presiding as chair.⁴

Thus, governors play a dominant role in the political dynamics and administration of provincial governments due to the absence of an elected provincial government body. This dominance is also entrenched because of governors' ability to appoint chosen members to the Provincial Assembly.

Office of the Provincial Administrator. Offices of the provincial administrator were established by the Organic Law of Provincial and Local Level Governments, §73 (1) (a). Provincial administrators are appointed centrally by the national government from a list of three names submitted by the Provincial Executive Council and after consultation with the

¹ Government of PNG. 1975. *Constitution of the Independent State of Papua New Guinea*. Port Moresby; and Government of PNG. 1995. *Organic Law on Provincial and Local-level Governments*. Port Moresby.

² Government of PNG. 2014. *District Development Authority Act*. Port Moresby

³ If a governor accepts a national ministerial appointment, then the chair of the Provincial Executive Council shifts to another MP in the province.

⁴ L. Kalinoe. 2009. Introduction to the Organic Law on Provincial and Local Level Government on Service Delivery. In L. Kalinoe, ed. *A Review of the Implementation of the OLPG & LLG: A Six Provinces Survey*. Port Moresby: Constitutional and Law Reform Commission of Papua New Guinea.

Public Service Commission. The ability of governors, through provincial executive councils, to determine the shortlist for new provincial administrator, is another tool in influencing the administration of provinces.

Provincial administrators are the chief executive officers of provincial governments and administrative heads of all staff in a province. They are the chief accountable officers for purposes of the Public Finances (Management) Act. As a result, they spend a large amount of time supervising and managing all public funds in a province. There are different approaches to managing provincial finances, with the most extreme being in Enga where the provincial administrator countersigns every check issued by the provincial government.⁵

As chief executive officers of the provinces, provincial administrators are responsible for all administrative services and the delivery of basic government services in the provinces. With the exception of law enforcement staff, provincial administrators maintain overall supervision and direction over all officers and employees assigned to or employed in the provinces carrying out any functions of the national, provincial, or local governments.

Provincial administrators may delegate by written instruments, any such powers relating to the administration or management of projects or such other work activity in a particular district, to relevant district administrators.

Provincial Executive Council. The Organic Law of Provincial and Local Level Governments, §25, along with the Provincial Governments Administration Act 1997, §15 (1) provides provincial executive councils with the powers to establish any committee by their own resolution. As such, all provincial governments have established a joint provincial planning and budget priorities committee in their provinces. Provincial governments do not have discretion to determine committee membership, as it is set in the Organic Law of Provincial and Local Level Governments, §25 (2):

- (i) not the governor, but a member of the Provincial Executive Council appointed by the governor to be the chair;
- (ii) the chairs (or their nominees) of the Joint District Planning and Budget Priorities Committee; and
- (iii) three other members appointed on an ad hoc basis by the Provincial Executive Council.

Although the Organic Law of Provincial and Local Level Governments stipulates that membership excludes the governor, governors still exercise effective control either by ignoring the law and assuming the chair,⁶ or through the appointment of their allies.

Joint Provincial Planning and Budget Priorities Committee. The functions, roles, and responsibilities of the Joint Provincial Planning and Budget Priorities Committee are to:

- (i) oversee, coordinate, and make recommendations concerning the overall planning in the province, including budget priorities, for consideration by the national government;

⁵ Author's own observation in discussions with the provincial administrator of Enga.

⁶ Examples are detailed in footnote 75.

- (ii) determine and control budget allocation priorities for the province;
- (iii) approve provincial government budgets for presentation to the Provincial Assembly;
- (iv) draw up a rolling 5-year development plan and annual budget estimates for the province; and
- (v) conduct annual reviews and assessment of the rolling 5-year development plan.

The committee was intended to be the central planning, coordination, monitoring, and evaluation institution in a province.

Office of the District Administrator. The Organic Law of Provincial and Local Level Governments, §73 (1) (b) created offices of the district administrator. Currently, district administrators are public servants appointed by the national Department of Personnel Management. As each district's boundaries are determined along the lines of the open-electorate boundaries, it is advantageous for district administrators to have close working relationships with the open-electorate MPs of their districts.

District administrators are the chief executive officers of the District Development Authority and administrative heads of all staff. They are most senior government officials on the ground at the district level, and they must ensure that all government services are being delivered. Reporting lines for District administrators are blurred as they have responsibilities under the Organic Law of Provincial and Local Level Governments, §74 (3) to comply with any administrative directives from provincial administrators or policy directions from provincial governments, while also being answerable to the District Development Authority board. Other responsibilities include⁷

- (i) performing and discharging roles and responsibilities as directed by provincial administrators either relating to provincial government functional responsibilities or those of national government departments and agencies;
- (ii) coordinating all support services for local governments within districts;
- (iii) supervising and coordinating formulation of policies and the implementation of these policies and programs within the framework of the district development plans and being further responsible for the maintenance of appropriate and basic data for project planning and formulation of policy;
- (iv) liaising and consulting with district treasurers on budget and treasury matters for the district; and
- (v) being chief executive officers of the District Development Authority and therefore responsible for the planning, implementation, and supervision of all work programs and activities sanctioned by the committees in the district, local government, and ward areas.⁸

District Development Authorities. In December 2014, the District Development Authority Act and consequential amendments to the Organic Law of Provincial and Local Level Governments, abolished the joint district planning and budget priorities committees and created District Development Authorities as formal legal entities responsible for

⁷ See §74(2) (d)–(h).

⁸ Footnote 75.

administering services in the Districts. The board to the District Development Authorities are the key decision making and oversight committees in the districts that consider all matters relating to district project planning and budget allocations. The law details a number of functions, roles, and responsibilities such as:

- (i) overseeing, coordinating, and making recommendations for the provincial government and the national government concerning all work plans, programs, and activities and budgets and priorities for districts;
- (ii) determining the budget allocation priorities for local governments in districts;
- (iii) approving the local budgets for presentation to the local governments, and making appropriate recommendations concerning these budgets;
- (iv) drawing up rolling 5-year development plans and annual estimates for districts; and
- (v) conducting annual reviews of the rolling 5-year development plans.

The board of District Development Authorities are chaired by MPs. Local government presidents, within a respective district, are members, and an additional three persons are appointed directly by the MPs. Thus, the boards are controlled by the open-electorate MPs, making development priorities of the district often determined by MPs' political agendas rather than broader service planning considerations.

Originally, the joint district planning and budget priorities committees were reliant on the provinces to fund their development plans, which created incentives for those plans to be aligned, and reinforced the authority of the governors and provincial budgeting process. However, significant funding flows directly to the District from the national government have led to disjointed development priorities.

Treasuries. Provincial and district treasuries are geographically located at the provincial and district headquarters but are not part of the provincial or district administration. They are an extension of the national Department of Finance, and the treasurers are staff of the Department of Finance. Their staffs are appointed through the normal national government public service process and are supervised by, and have allegiances with, the Department of Finance. The aim of separating the treasuries from the provincial and district administrations is to protect against misappropriation and misuse of public finances.

Treasuries manage the disbursement of public monies for both recurrent and development expenditure in accordance with the Public Finances (Management) Act. Not all districts have a district treasury, with the Department of Finance continuing to fund the construction of treasury buildings and installation of computer systems. Other factors also reduce the effectiveness of treasury operations, including lack of electricity and communications.

APPENDIX 2

Who Controls Subnational Government Revenue and Expenditure?

Table A2.1: Funding Sources by Level of Government

	Provincial	District	Local	Facility
Own-source revenue	Yes	No	Some fees for cost recovery in urban local governments	Some fees for cost recovery
Function grants (recurrent)	Yes	No	Yes	No
Services Improvement Program (capital)	Yes	Yes	Yes	No
Payroll funded by national government	Yes	Yes	Some allowances paid	Yes
Direct facility payments	No	No	No	Yes, education tuition subsidy
Other variable budget allocations from higher levels of government	No	Yes, function grants passed down from province	Varies by province	Yes, function grants passed down from province
Local infrastructure projects funded by national government	Yes via submission to Public Investment Program	Yes via submission to Public Investment Program	Submission normally made by province	Submission normally made by province

Source: Government of PNG, Department of Treasury. 2013. 2014 Budget. Port Moresby.

Table A2.2: Effective Control of Subnational Revenue Bases

Revenue Base	Governor	Provincial Administration	Open-Electorate Member of Parliament	District Administration
Own source revenue, goods and services tax, and resource royalties	Untied, some use this revenue for service delivery funding, others for infrastructure projects			
Function grants (equalization payments)		Tied to recurrent expenditure on service delivery		Tied to recurrent expenditure on service delivery
Provincial Services Improvement Program	Must be used to fund development projects			
District Services Improvement Program			Must be used to fund development projects	
Local Services Improvement Program			Must be used to fund development projects	
Staffing grant		Tied to approved staffing structure, paid directly to employees		

Source: Author's calculations.

Numerous national level government agencies also play an important role in the determination and allocation of funding to subnational governments. These include:

- **Department of Treasury.** All provincial budgets are approved by the Department of Treasury as part of the budget process. The Department of Treasury has a branch dedicated to engaging with provinces on their budget formulation, which also manages the disbursement of grants according to cash flow requirements of the national government and provinces. The Provincial Budgets Branch also undertakes quarterly reviews to track the progress of provincial budget execution.
- **Provincial and Local-Level Service Monitoring Authority.** PLLSMA is the centrally designated institution that monitors and evaluates the effectiveness of services delivery and administration at the subnational level. Administratively, the authority operates within the Department of Provincial and Local Government Affairs. PLLSMA's mandated responsibilities include (i) coordinating and monitoring the implementation of national government policies at the provincial

and local level, (ii) supporting the Auditor-General's Office to audit provincial and local governments, (iii) training and supporting national public service staff members assigned to provinces and districts, (iv) advocating for reforms to strengthen the decentralized system of government, and (v) ensuring that all public service appointments are based on merit. It also has a wide-ranging scope to intervene in provincial and local government affairs when necessary. PLLSMA was envisioned to play a central role in ensuring subnational entities were effectively run; however, this body has not been effective in undertaking its responsibilities, which arguably has contributed to the current poor state of rural services delivery.¹

- **National Economic and Fiscal Commission.** The Constitution, §187H and Organic Law of Provincial and Local Level Governments, §117 both make provisions for the creation of NEFC as a committee to provide independent advice to the government and National Parliament on fiscal arrangements at the national and subnational level. Despite being a constitutionally mandated commission, NEFC was not a functioning body until 1998. NEFC continues to play a role in administering the horizontal fiscal equalization system by making an annual recommendation to the Department of Treasury on the distribution of functional grants. These recommendations are based on the formula within the Intergovernmental Relations (Functions and Funding) Act 2009. In addition, NEFC also produces a number of knowledge products, the best known being the annual Provincial Expenditure Review. NEFC has taken the view that its current scope is limited to the availability and use of funds for recurrent nonsalary expenses. This is in contrast to the Office of Rural Development, which focuses on development funds and expenditure.
- **Office of Rural Development.** The SIP is notionally administered by the Office of Rural Development through the publication of administrative guidelines that detail the processes to which subnational entities must adhere when spending these grant funds. The Office of Rural Development is also responsible for collecting and acquitting the expenditure receipts in an attempt to ensure that program funds are not misused. They are also in the process of developing a database, which details the current state of development of each district.

¹ Refer to footnote 75, and R. J. May, 2006. The Public Sector Reform Process in Papua New Guinea: Public Policy in Papua New Guinea. *Discussion Paper Series 2006*. No. 4. Canberra: The National Research Institute and State Society and Governance in Melanesia, Australian National University. p.12.

APPENDIX 3

Services Improvement Program Administrative Requirements

Notionally, SIP grants are only tied to expenditure within infrastructure services, health, education, law and justice, economic, and community development sector support. Specific legal requirements for the use of SIPs are detailed below.

Project Size	Project Documentation Requirements	Procurement, Tender, and Selection Requirements
Up to K5,000	Project formulation document Three verbal quotes	District Administrator (or above)
K5,000–K50,000	Project formulation document Three written quotes Proforma contract Other requirements depending on sector	District Administrator (or above)
K50,000–K300,000	Project formulation document Proforma contract Authority to precommit Other requirements depending on sector	Provincial Administrator/ District Supply and Tenders Board ^a
K300,000–K3 million	Project formulation document Minor contract document for projects up to K500,000 Major contract document for projects above K500,000 Authority to precommit Other requirements depending on sector	Provincial Supply and Tenders Board/District Supply and Tenders Board
K3 million–K10 million	Project formulation document Major contract document Authority to precommit Other requirements depending on sector	Provincial Supply and Tenders Board/District Supply and Tenders Board
More than K10 million	Project formulation document Major contract document Authority to precommit Other requirements depending on sector	Central Supply and Tenders Board and National Executive Council approval

^a Creation of the District Supply and Tenders Board and procurement limit (up to K10 million) by determination of the Minister for Finance (§27, *District Development Authorities Act 2014*).

Sources: Government of PNG, Office of Rural Development. 2013. PSIP, DSIP and LLGSIP Administrative Guidelines. Port Moresby; Government of PNG, 2014. *District Development Authority Act*. Port Moresby.

Wok Bung Wantaim

Using Subnational Government Partnerships to Improve Infrastructure Implementation in Papua New Guinea

This report examines how existing implementation structures established under ADB and National Government investment programs could be used to channel subnational government resources toward priority infrastructure investments more effectively. The report considers the legal and institutional issues associated with ADB expanding its subnational partnerships and proposes a number of coordinated engagement frameworks that are aligned with the PNG Public Financial Management Act (1996).

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ASIAN DEVELOPMENT BANK

6 ADB Avenue, Mandaluyong City

1550 Metro Manila, Philippines

www.adb.org