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Report No: 19590-PNG

**MEMORANDUM OF THE PRESIDENT
OF THE
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
TO THE
EXECUTIVE DIRECTORS
ON A
COUNTRY ASSISTANCE STRATEGY
OF THE
WORLD BANK GROUP
FOR
THE INDEPENDENT STATE OF PAPUA NEW GUINEA**

October 21, 1999

Papua New Guinea and the Pacific Islands Country Unit
East Asia and Pacific Regional Office

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CURRENCY EQUIVALENTS

(Exchange Rate Effective September 1, 1999)

Currency Unit: Papua New Guinea Kina (K)

K 1.0 = US\$0.35

US\$1.0 = K 2.9

FISCAL YEAR

January 1 to December 31

WEIGHTS AND MEASURES

Metric System

DATE OF LAST CAS

August 29, 1995

Vice President	: Mr. Jean-Michel Severino, EAPVP
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GLOSSARY OF ACRONYMS AND ABBREVIATIONS

APL	Adaptable Program Loan
ADB	Asian Development Bank
AusAID	Australian Agency for International Development
BPNG	Bank of Papua New Guinea
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
CBO	Community-Based Organization
CCFF	Compensatory and Contingency Financing Facility
CDF	Comprehensive Development Framework
CG	Consultative Group
CMU	Country Management Unit
CPAR	Country Procurement Assessment Report
CPI	Consumer Price Index
CPPR	Country Portfolio Performance Review
ERP	Economic Recovery Program
GDP	Gross Domestic Product
GNP	Gross National Product
GEF	Global Environment Facility
GRA	Gazelle Restoration Authority
IBRD	International Bank for Reconstruction and Development
ICAC	Independent Commission Against Corruption
ICR	Implementation Completion Report
IDF	Institutional Development Fund
IFC	International Finance Corporation
IMF	International Monetary Fund
IMR	Infant Mortality Rate
LIL	Learning and Innovative Loans
MIGA	Multilateral Investment Guarantee Agency
MTDS	Medium-Term Development Strategy
NGO	Nongovernmental Organization
OED	Operations Evaluation Department
OECF	Overseas Economic Cooperation Fund
PER	Public Expenditure Review
PFPF	Population and Family Planning Project
PHRD	Population and Human Resources Development
PIIF	Pacific Islands Investment Facility
PNG	Papua New Guinea
PNGBC	Papua New Guinea Banking Corporation
SAL	Structural Adjustment Loan
SEDP	Social and Economic Development Program
SPPF	South Pacific Project Facility
TCDP	Targeted Community Development Program
VAT	Value Added Tax
UN	United Nations
UNDP	United Nations Development Program
WBI	World Bank Institute
WHO	World Health Organization

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CONTENTS

Executive Summary	i
1. SOCIOECONOMIC, POLITICAL AND CULTURAL CONTEXT	1
A. Socioeconomic Context, Poverty and Human Development	1
B. Political Context and Cultural Backdrop.....	3
C. Economic Performance, Recent Developments and the Reform Agenda.....	6
D. Outlook and External Environment.....	11
E. Papua New Guinea's Development Challenge	11
2. PAPUA NEW GUINEA'S DEVELOPMENT AGENDA.....	13
A. Papua New Guinea's Medium-Term Development Strategy.....	13
B. PNG's Partners in Development.....	14
C. Civil Society's Views and Aspirations: A Vision for PNG.....	15
3. BANK GROUP COUNTRY ASSISTANCE PROGRAM.....	17
A. Progress Toward Objectives of the Previous CAS—An Unfinished Agenda.....	17
B. The Country Assistance Strategy.....	19
C. Vehicles for Bank Assistance	24
D. Country Program Monitoring.....	26
E. Risks.....	28
4. CONCLUDING REMARKS.....	29
Attachment 1: Social Services in Crises—Press Coverage of 24 April 1999.....	30
Attachment 2: Donor Support to PNG: Ongoing and Pipeline Intervention on a Sector-by-Sector Basis (Investments and Technical Assistance).....	31
Attachment 3: The Participatory Process of the CAS.....	34
Attachment 4: PNG—Portfolio Profile, Performance and Implementation Issues.....	37
Annex A2: Papua New Guinea at a Glance.....	41
Annex B2: Papua New Guinea—Selected Indicators of Bank Portfolio Performance and Management.....	43
Annex B3: Bank Group Program Summary.....	44
Annex B4: Papua New Guinea: Summary of Analytical and Advisory Activities.....	45
Annex B5: Papua New Guinea: Social Indicators.....	46
Annex B6: Papua New Guinea: Key Economic Indicators.....	47
Annex B7: Papua New Guinea: Key Exposure Indicators.....	49
Annex B8: Status of Bank Group Operations in Papua New Guinea	50
Annex B9: CAS Program Matrix (FY00-02).....	51
Annex B10: CAS Summary of Development Priorities.....	62
TABLES IN TEXT	
Table 1: Social Indicators in Papua New Guinea Compared, 1997.....	1
Table 2: OED Recommendations and Bank Strategies.....	18
Table 3: Indicative Assistance Program, Lending Scenarios and Triggers.....	27

BOXES IN TEXT

Box A: Poverty and Inequality in Papua New Guinea.....2
Box B: Women in PNG Society.....4
Box C: Society, Culture and Politics—A PNG Context.....5
Box D: Key Economic Indicators - 1980-1998.....7
Box E: PNG Medium-Term Development Strategy (1997-2002).....13
Box F: Involvement of Development Partners in PNG’s Reform and Development Agenda.....15
Box G: A Vision Statement for Papua New Guinea16
Box H: Status of Portfolio.....25

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EXECUTIVE SUMMARY

- i. **Social, Political and Economic Context.** *“Services are not getting to the people, health posts are closing, schools are underfunded, politicians are too preoccupied with survivalist politics and their wantoks (relatives and clan members) to do their job effectively.”* This message was delivered over and over again to the World Bank team undertaking consultations on the hopes, ambitions and vision for the future of Papua New Guinea in the context of the preparation of the Country Assistance Strategy (CAS). The people of Papua New Guinea (PNG) want better governance and a development strategy that will focus more of the country’s resources on social and human development, particularly in rural areas. With 38 percent of the population now living at or below the poverty line (over 90 percent of whom live in rural areas), the task of avoiding further deepening of the emerging social crisis is significant.

- ii. *Despite considerable natural wealth and substantial and sustained external assistance in nearly 25 years of independence, PNG has been unable to achieve significant tangible development outcomes.* The impact of years of mismanagement has taken a toll on the country’s social welfare and developmental progress. Falling health indicators and slow progress in education, compounded by worsening crime and poor infrastructure, have worsened living standards, especially among the most vulnerable groups—namely women and children living in rural areas. The link between inadequate primary health care, limited educational opportunities, poor or nonexistent infrastructure and persistent poverty has long been recognized in the PNG context and confirmed in the most recent assessment of poverty in PNG.

- iii. *On the political front, PNG has just emerged from another period of political uncertainty.* After an unconstitutional 7-month adjournment of Parliament, a no-confidence vote was avoided with the resignation of Prime Minister Bill Skate. The political posturing that ensued ended on July 14, 1999, when Parliament reconvened and members voted Sir Mekere Morauta to the position of Prime Minister. This development came about after an extended period of political uncertainty resulting from the fragility of the governing coalition. This uncertainty further undermined already low consumer and business confidence and worsened the severity of governance issues. The highly personal nature of the political system combined with the sociocultural backdrop of a clan-based society creates a political environment that is often volatile and inherently unstable, making the task of governing the country a difficult one in the best of times. The political imperative and often nontransparent conduct of fiscal and monetary policy has aggravated the depth and severity of internal and external shocks to PNG’s economy. The country has had three bouts with macroeconomic instability in the last 10 years. Meanwhile, the politicization of policy and public sector management has continued unabated. *Together with poor transparency and accountability in public administration, the result has been generally poor economic governance and unsatisfactory public sector performance in recent years.* The new government under Prime Minister Mekere Morauta has publicly recognized many of these issues and indicated its commitment to provide the necessary leadership to begin the difficult but necessary reform efforts.

iv. *After a short period of macroeconomic stability, the overall economic situation worsened considerably in the second half of 1997.* Natural disasters, ripple effects of the Asian financial crisis and generally depressed commodity prices have impacted PNG's macroeconomic health, stability and prospects. PNG's terms of trade shifted dramatically during 1998 as a result of lost export markets in Asia, resulting in lost revenues estimated at 15 percent of GDP. Drawdown of reserves (now at a five-year low) has put pressure on the local currency, the Kina, which has depreciated by 45 percent against the US dollar since 1997. The fiscal impact has been severe, particularly in the social sectors and development programs. The fiscal overhang from the 1998 budget and challenges of the 1999 budget are contributing elements to the heightened risk of a full-fledged fiscal crisis. A major part of the 1998 end-of-year spending was financed through advances from the central bank beyond statutory limits, leading to an apparent lessening of the independence of the central bank. Combined with slippages in budget implementation, there is evidence of continued buildup in arrears and rising pressure on inflation and balance of payments.

v. **Government Response to the Deepening Crisis.** The 1999 budget is a bold attempt to lay the foundation for an economic turnaround and for improved articulation, in fiscal terms, of the objectives of the Medium-Term Development Strategy (1997-2002). The budget attempts to shrink the national administration by 10 percent through an across-the-board retrenchment program and reorientation of spending from the national recurrent budget to development projects and direct disbursements to local communities. While the overall deficit was projected to remain unchanged from 1998 (about 2 percent of GDP), several of the underlying budget assumptions are already proving to be too optimistic. Most notably, a sharp reduction in recurrent spending is anticipated as a result of the public service retrenchment program, which has yet to be fully implemented and whose full effects would not be felt until the next fiscal year. Furthermore, deterioration in the fiscal management function has led to the apparent collapse of the budgetary process, resulting in poor ownership of the budget objectives and weak implementation to date. The need to fund the Government's operations has led to an apparent increase in nontransparent fiscal and quasi-fiscal operations. The response to the looming crisis has further highlighted the weak governance situation and the urgent need for structural reforms in a number of critical areas of public sector administration. The monetary response to the crisis has consisted of a sharp rise in interest rates. This has stemmed the flight of capital to some extent but has crushed new activities of the private sector. Central bank interventions to prop up the Kina have seriously depleted reserves and have effectively failed, with the Kina reaching all-time lows against the US and Australian currencies.

vi. Given poor budget performance during the first half of 1999, the new administration brought down a supplementary budget in August 1999 to address revenue shortfalls and expenditure pressures. This is a significant step in reestablishing a more credible and realistic fiscal program. The new government has also re-engaged with the Bank and IMF, seeking support for its stabilization and reform program. Discussions with the preceding government proved to be difficult and the level of forthrightness and cooperation by the authorities did not allow the Bank or IMF to move forward with comprehensive efforts to prepare adjustment and stand-by packages, respectively. Until recently, PNG had been pursuing other sources of financing to support its macroeconomic stabilization plan, including its first sovereign bond issue for US\$250 million on the Eurobond market. In the brief time since taking office, the Morauta administration has outlined its policy position and strategic direction in a number of areas of interest to the Bank. Most notably, the new government has: i) prepared and passed a supplementary budget which signals a significant change in direction, targeting a surplus in the second half of the year; ii) halted the poorly structured civil service retrenchment program; iii) reinstated funding for important institutions, and; iv) initiated a privatization program and set-up a privatization commission, with the intention of further rationalizing the use of government resources.

vii. **Bank Group Strategy and Program.** *The overarching goal of the PNG CAS is to support a concerted effort to reduce poverty and improve the quality of life of Papua New Guineans. The primary objective for this CAS period is to assist PNG in improving the foundation for a capable state that can be responsive to its people by addressing human and economic development challenges in a transparent and accountable manner. The Bank's capacity and ability to contribute to this ambitious objective will depend to a great extent on PNG's commitment to these objectives, both in spirit and in practice, and on the level and effectiveness of engagement of other donors. The CAS objectives will be pursued through the implementation of an operational strategy that will support: (a) improvements in the governance framework for sustainable development, and; (b) enhanced rural development. The need to focus on governance issues is overwhelming. The basic public sector operations intended to provide services to rural areas are not working properly. Poor service delivery is not due to a lack of government financial resources, but is a direct result of public sector mismanagement, poor accountability mechanisms and unwillingness to make service delivery a priority in practice. Improved governance is at the core of the service delivery challenge and it must be pursued through a judicious set of policy and public sector reforms. The effectiveness of sector lending and development assistance in general is dependent on it.*

viii. The Bank's country assistance strategy (CAS) responds to the pressing need for fiscal support and for stabilizing the macroeconomic environment, but it does so in the context of a broader strategy dealing with the underlying poor governance issues that have hindered PNG's ability to sustain macroeconomic stability and achieve sustainable human development and poverty reduction. The CAS will support efforts to reestablish economic growth and improve confidence by enhancing the transparency and effectiveness of public sector operations and investing in human and rural development, while at the same time supporting efforts to reestablish a more solid framework for private investment. This agenda recognizes the importance of establishing transparent fiscal management, and the need for a sound financial system. Rebuilding confidence in the Government's ability to carry out fiscal and monetary policy in an effective manner is critical. This program demands unflinching commitment on the Government's part, transparency and consistency in policy implementation, accountability of government officials and close cooperation with the Bank and IMF. The Bank's support, therefore, aims to create a viable foundation for successful reform in the medium and long term. The Bank has conveyed its readiness to provide assistance through a structural adjustment loan to support PNG as part of a joint Bank/IMF program. Furthermore, the Bank is emphasizing the importance of donor coordination given the need to improve the overall effectiveness of development assistance.

ix. While PNG's development needs are substantial and the fiscal situation difficult, the Bank's program remains cautious and focused. The lending and nonlending activities in this CAS have been formulated on the basis of the following considerations: (a) PNG's development needs, priorities and views on how and where the Bank can make a contribution to its development program; (b) the Bank's *comparative advantage* vis-à-vis those of other donors in sector or country-specific areas; (c) the Bank's operational experience in PNG and lessons learned from recent project implementation failures and successes; (d) the country's implementation performance at both policy and project levels; (e) significant involvement and engagement of other bilateral and multilateral donors that provide PNG with official development assistance amounting to more than US\$80 per capita, and; (f) the Bank's role and responsibility in promoting responsible environmental management and global environmental protection and conservation.

x. The Bank is presently operating in PNG on the basis of the low-case lending scenario, consisting of a three-year investment program of US\$50-100 million. The program focuses on sectors where the Bank has demonstrated effective implementation mechanisms (such as the Second Gazelle Restoration Project and resource-sector technical assistance), or where strategic considerations in terms of global

environmental protection (Forestry and Conservation Project) and partnerships (Highlands Highway) are significant and provide the leverage necessary for more effective implementation. The Bank will continue its dialogue with the authorities in close cooperation with the IMF to establish and agree on a program to restore macroeconomic stability and improve the transparency of the Government's fiscal and monetary activities. Should the dialogue prove constructive and common ground on critical policy reforms found, the Bank stands ready to engage more broadly and move to the base-case lending program. This would also be contingent on progress in addressing portfolio performance issues. The base-case program envisages lending on the order of US\$200-250 million for FY00-02. The cornerstone of the base-case program is a comprehensive structural adjustment loan (SAL). In addition to providing balance of payments support, the SAL would support a number of structural reform efforts and set the stage for more in-depth reforms through targeted sector lending operations. PNG is intensifying efforts to transition from the low-case to the base-case lending scenario. A SAL is therefore a possibility in the second half of FY00. The base case would also include a limited number of sector operations focusing on the core rural development strategy, particularly rural infrastructure and service delivery matters.

xi. **Outlook and Risks.** In the short term, PNG still faces many risks in its efforts to regain control of the economy and reestablish growth. The main challenge will be for PNG to establish and maintain a transparent fiscal discipline for the remainder of 1999 and 2000 budget, and to prevent further deterioration of the fiscal situation that could spill over into the financial sector. Reaching agreement with the IMF will also be critical given that it is a necessary pre-condition for Bank involvement through a SAL. Overall, economic prospects for Papua New Guinea are, at best, modest over the short to medium term, and subject to a number of external and internal risk factors. Commodity prices appear to have entered a prolonged period of price softness although some gains (particularly oil) have been made in recent months. Agricultural output is also recovering from the 1997 lows. The economy will therefore remain susceptible to some volatility on account of external factors and to the internal governance issues that are undermining the proper functioning of the government apparatus.

xii. The Bank's ability to deliver assistance through a structural adjustment program and follow-up with targeted sector lending will depend on PNG's willingness to work with the Bank and IMF in a constructive and cooperative fashion. While certain operational issues have been resolved, the inconsistent attitude toward the Bank has strained the relationship. A true partnership focused on implementation of a comprehensive development program is being actively pursued by the Bank.

xiii. **Agenda/Issues for Board Consideration.** The Board may wish to discuss the following issues:

- Selectivity and strategic partnerships: is the strategic focus too narrow, given the Bank's absence from certain sectors, particularly health, where other donors have on-going programs;
- Triggers for base-case scenario: are the triggers for the base-case scenario appropriate, particularly in the context of PNG's inconsistent performance on policy issues and implementation.

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1. SOCIOECONOMIC, POLITICAL AND CULTURAL CONTEXT

A. SOCIOECONOMIC CONTEXT, POVERTY AND HUMAN DEVELOPMENT

1. Social and economic development in Papua New Guinea (PNG) is difficult. The country's mountainous terrain and dispersed islands, limited infrastructure and low level of human resource development are formidable obstacles. PNG is a young country and the process of nation-building and social development has only just begun. Its population of about 4.6 million, which is divided into about 800 language groups, has a cultural heritage that is rich and diverse. PNG is also endowed with an extraordinary variety of land and marine ecosystems that are unique in the world. The country harbors more than 5 percent of the world's biodiversity on less than 1 percent of the world's land area.

2. With a 1998 per-capita income of US\$890, PNG is at the lower end of the low-middle-income country category. This income level has not translated into broad-based social development. Social indicators have shown little or no improvement in recent years and compare unfavorably with those of neighboring and comparator countries (Table 1). In fact, *PNG's social indicators are characteristics of a country at a much lower income level.* According to UNDP's human development index, PNG ranks 128th out of 175 countries. *It is widely acknowledged that this is a result of the failure to deliver social services on a sustainable basis, albeit in a very rugged environment, and the low level of investment in human and rural development.*

Table 1: Social Indicators in Papua New Guinea Compared, 1997

Indicator	Papua New Guinea	Fiji	Thailand	East Asia	Low-Income Countries ^a
Infant mortality per 1,000 live births	64	21	34	39	68
Life expectancy at birth (years)	58	71	69	68	63
Primary school enrollment (percent)	80	125	87	115	107
Secondary school enrollment (percent)	14	-	32	65	56
Literacy (percent)	52	85	93	76	51

^a Excludes China, Source: World Bank, Social Indicators of Development 1998.

3. *Poor service delivery combined with a growing population and stagnating economic growth is increasing the level of poverty.* According to a 1996 household survey, about 38 percent of the population lives below the poverty line. These households have a level of consumption below what is needed to achieve the minimum nutritional intake and to purchase required nonfood items. Disparity in consumption and welfare along the lines of gender and urban versus rural population is significant and growing (Box A). The Government's administrative capacity is stretched to the limit by the demands for social services from a population that is young, growing rapidly and geographically dispersed.

Box A: Poverty and Inequality in Papua New Guinea

Most Papua New Guineans are generally uncomfortable with the term "poverty," finding it inconsistent with the country's wealth in natural resources, agricultural heritage, vast cultural diversity, and close-knit and supportive kinship system. They mention that in Papua New Guinea's traditional society (which continues in the villages and, to some extent, in urban settings), everyone was expected to share available food and shelter with one's wantoks (ethnic group members speaking the same language). From this they conclude that no one can have been in dire need, although available evidence indicates high rates of malnutrition, morbidity and mortality. To acknowledge that poverty exists is therefore to have to admit that the traditional structure of society does not provide for everyone's minimum needs and, for that matter, may never have done so, since the resources available to the wantok group may often have been insufficient to provide for everyone's basic needs. In spite of the cherished beliefs in the efficacy of the wantok system, most Papua New Guineans would agree that the well-being of a large portion of the population falls short of the minimum acceptable standard of living that should include a sufficient supply of nutritious foods and certain other basic items considered essential, as well as access to safe water, adequate health care, educational opportunities, transportation and communication services. The Bank's recent work on the PNG Poverty Assessment reveals that the following factors are closely correlated with being in poverty: living in a rural area; living in a household where the head of household is relatively older, and/or is female, and/or has had little or no formal education or is illiterate, and/or has little or no cash income; limited or no access to or use of healthcare facilities; limited consumption of rice, wheat products or meat; limited or no access to safe water supply or sanitary facilities. The ability/opportunity to earn cash is an important determinant of whether a person is poor or not. The Poverty Assessment also revealed the following factors about the nature and causes of poverty in Papua New Guinea.

Poverty and Income Disparity

A household survey of roughly 1,200 households in both rural and urban areas was carried out in 1996. Results suggest that, based on the cost of basic needs, 38 percent of the population live in households where the consumption level is below that needed to achieve the minimum nutritional intake and to purchase a set of nonfood items that are considered to be minimum requirements. According to this consumption-based criterion, significant (and seemingly entrenched) differences exist between the top and bottom quartiles of the population; while the richest 25 percent have a calorie availability about 90 percent in excess of the recommended daily intake, the poorest 25 percent have a calorie availability of only 89 percent. Additionally, the lot of the bottom quartile has hardly improved since 1984 when empirical evidence estimated their consumption level to be 82 percent. The survey also reveals that about 16.6 percent of the poor live in households where the head is unemployed; 42.5 percent in households where the head is a tree crop farmer and 19 percent in households where the head's main source of income is domestic agriculture. Furthermore, the richest 10 percent of the population account for 36 percent of consumption, while the poorest 50 percent account for only 20 percent. On the whole, low education levels, poor service delivery, limited employment opportunities and inadequate institutional/infrastructural support account for this growing disparity.

Rural vs. Urban Poverty

The survey allowed comparisons across four regions of PNG: the North Coast (Momase) region, the South Coast (Papua) region, the Highlands, and the New Guinea Islands. The National Capital District was treated as a fifth region. Significant bias exists in the provision (and quality) of infrastructure and social amenities/services in the urban and rural areas. Although this has triggered and sustained significant rural-urban migration in recent years, apparent neglect has caused poverty to deepen in the rural areas in both absolute and relative terms. Over 94 percent of those below the poverty line reside in rural areas. For example, in the Momase Region, the poverty rate for the urban sector (20.3 percent) is half that observed in the rural sector (46 percent). In the National Capital District, only 26 percent of the population fell below the poverty line, which represent only 4 percent of the poor in PNG. Statistical analysis of the 1996 survey results shows strong linkages between the low quality of life in the rural areas and unemployment, education and the quality of service delivery. It appears that deprivation and poor access to social services in the rural areas is reinforced by low cash incomes, poor communication facilities, inadequate support for self-starters and capacity constraints.

Poverty and Gender

The 1996 household survey revealed serious gender disparities, the most disturbing of which concern access to health and education facilities; consequently, women have lower living standards and are more likely to suffer deprivation when economic circumstances change for the worse. This gender inequity has its roots in the inequities still present in access to social services as well as employment and financial services. Of the 50 percent of the poorest quartile of the population who have never attended school, roughly 60 percent are women; this largely derives from entrenched attitudes that result in relatively higher investment in the education of boys than girls. Empirical analysis indicates that an extra year of education for a female is three times more effective in improving child growth than is an extra year of education for males. This supports the Government's recent emphasis on reducing gender inequity in this regard.

4. *Provision of basic health services has been unsatisfactory over the past two decades, with marked deterioration in the level and quality of healthcare facilities, especially in the last decade and outside major towns.* Estimates from the 1996 Demographic and Health Survey indicate an infant mortality rate of 64 per 1,000 live births, compared to 72 per 1,000 in 1981. Of particular concern is the increase in immunizable diseases caused by the decline in visits to health centers by women and children in rural areas. In 1980, the total fertility rate was 5.4 children per woman, and by 1995 it had declined marginally to 4.8. About 42 percent of the population is under the age of 15. The population growth rate is 2.3 percent a year, and, at the present rate, the population is expected to double to about 9 million in 30 years. The urban population, which accounts for less than 15 percent of the total population, is growing at an even faster rate, 4.6 percent, and it will have doubled by the year 2005.

5. *PNG's education indicators do not compare well with countries at similar levels of income although they have recently begun to show improvement.* An Education Sector Review in 1991 reported low enrollment, high dropout rates, low quality and a generally unsuitable curriculum. The national and provincial governments undertook a joint effort to improve the situation through the education reform process that was begun in 1993. The gross primary enrollment had reached 80 percent by 1996 and continues to rise. Enrollment in secondary education is also expanding rapidly and construction of new high schools is ahead of schedule. Education is widely perceived to be too important an activity to be abandoned. Even when government-supplied teachers and textbooks are slow in arriving, parents and communities make tremendous sacrifices to ensure that the education process continues. *Although efforts have been made to increase female participation, the education system has been characterized by a severe bias against girls, in enrollments and attainment.* In 1996, females accounted for only 33 percent of total enrollments. Girls' poor access to educational opportunities hinders their social and economic development. Surmounting the educational barrier is but one of the challenges facing PNG women. A brief overview of the sociocultural developments that have influenced the role and position of women in PNG society is presented in Box B.

6. *The growing law and order problem has negatively affected the quality of life of Papua New Guineans.* In many areas of PNG there is a cultural disposition to the use of force to resolve conflict situations. Over time, traditional frameworks that control and regulate such conflicts have weakened. Rural-urban drift and a rising unemployment rate among young males have contributed to a significant law and order problem that has worsened in recent years. There is a growing severity in the nature of crimes and an increasing level of violence by criminals, particularly by those operating in gangs in the urban areas, the *raskols*. The problem has affected the quality of life of rural and urban residents, imposed substantial costs on conducting business in PNG and created yet another impediment to service delivery. A general sense of insecurity has taken hold of Papua New Guineans, particularly in the urban areas. The cost of crime has been estimated at 1.5 percent of gross domestic product (GDP). Attachment 1 provides a glimpse of the growing social and service delivery crisis, and the impact on people as reported in the Post Courier, a leading local newspaper.

B. POLITICAL CONTEXT AND CULTURAL BACKDROP

7. PNG is a parliamentary democracy based on the Westminster model with general elections held every five years. *The country's political system is characterized by its high volatility and party system where party affiliation is not generally based on shared political convictions or common platform, but on personal allegiances and political expediency. Sudden shifts between parties happen frequently and votes of no confidence are a common occurrence.* This leads to great uncertainty and instability after the 18-month grace period on no-confidence vote for a newly elected government is over. In fact, no government has ever lasted the full term since PNG gained its independence in 1975.

Box B: Women in PNG Society

Historical and Geographic Factors: Traditionally the status of women varied greatly across PNG societies. In some matrilineal societies, as in Milne Bay, women held power over land and other resources, while in most patrilineal societies, as in the Highlands, women had relatively little power. However, in all societies the colonial period saw a systematic reduction of the power of women. Male colonizers from patrilineal/patriarchal societies preferred to contact and work through other males. Even where land or resources were traditionally controlled by women, men were consulted and placed in positions of authority concerning them. Exceptional geographic diversity, and isolation of many societies, produces problems of communication and transport, which further disadvantage women. Most official links to the outside world are male, and women are often unwilling to interact with them even when they can gain access. Parents hesitate to send girls long distances for education, and those who go experience more anxiety, stress and security concerns than do their male counterparts.

Economic and Livelihood Activities: In most economic areas women are the producers, while men are the transactors. In subsistence agriculture women's labor inputs tend to be greater, but men have more control over the products. In cash cropping labor inputs are more equal, but ownership of the products is again monopolized by men. In estate or large operations women are vastly underrepresented in ownership, management and employment. Other large-scale economic activities, such as forestry and mining, are also dominated by men. The one area in which women often control the transaction, local open markets, provides very low returns. Increased commercial activity by women is limited by lack of small-scale credit.

Social Indicators: Infant mortality rates are very high, maternal mortality rates are among the highest in the world and life expectancy among the lowest. Key issues in maternal health are malaria, now spreading to previously immune areas, poor nutrition and inadequate birth spacing. Low life expectancy is attributed to poor nutrition, high maternal mortality, an arduous workload and high levels of violence against women. Violence against women is endemic in PNG. A recent World Health Organization (WHO) report indicated that PNG had the world's second highest incidence of domestic violence against women. The fear of rape is widespread, not only in urban areas, and restricts freedom of movement and the ability to act independently. PNG illiteracy rates are high, and the gender disparity is striking, with 60 percent of adult women unable to read. Males outnumber females at every level of schooling. Overall only 40 percent of school age girls attend school and women constitute only 30 percent of tertiary students (mostly in traditional female areas).

Political Participation and Legal Status: Women have the right to vote, and do so in large numbers. However, the tradition of male involvement in public affairs has seen men dominate political and bureaucratic structures. There has been little willingness on the part of the political elite to deal substantively with issues affecting women's participation and rights. Though women have protection under the Constitution and legal framework, practice often falls far short of the legal ideal.

Areas for Action: The PNG Platform for Action was developed by the National Council of Women after extensive consultation and participation, partly in response to the Beijing meetings of 1995. The Post-Beijing Declaration for Action and the Post-Beijing Report identify four priority areas from the Platform for Action, including: (a) to strengthen current national, provincial and local women's credit facilities and conduct a comprehensive feasibility study leading to the participation in Women's World Banking; (b) to mainstream gender issues in all government policies and development planning and administration; (c) to increase funding for women and children in the areas of health, education and literacy; and (d) to work toward the establishment of the Office of the Status of Women. Training at the community level, as well as at the higher levels of government and business, is essential as a first step in changing these attitudes. Guidelines and regulations concerning discriminatory behavior are also necessary and need to be seriously enforced. At the same time, care must be taken to not put women at increased risk through well-intentioned strategies that have the unintended consequences.

8. *PNG's electoral system and process further exacerbate political instability.* A large number of candidates compete in elections, and, with a first-past-the-post election system, a small percentage of votes may be sufficient to carry the seat. More than half the winners in the 1997 elections obtained less than 20 percent of the votes. Not surprisingly, and in line with the *wantok* social structure, winning candidates are expected to reward their supporters, and usually do so by supporting projects in narrow parts of their constituencies rather than representing their electorate at large. The net result is the creation of further divisions and friction in an already fragmented society. *The nature of the political system combined with the sociocultural backdrop of a clan-based society creates a political environment that is inherently unstable, making the task of governing the country a difficult one at best.* The political imperative also leads to numerous changes in key cabinet appointments and senior public sector positions, greatly reducing the effectiveness of office holders who have little time to implement often very demanding programs and policies. The culture-politics nexus is discussed in some detail in Box C.

Box C: Society, Culture and Politics—A PNG Context

Sociocultural Fragmentation of Traditional Life. The most salient element of PNG traditional sociocultural structure is the extreme fragmentation among social groups. With about 800 different language groups, most of which are separate sociocultural groups as well, traditional societies are usually small. Cooperation is strong within groups, but drops precipitously between groups. This means that social capital between groups is very weak. There is little trust or tendency to cooperation between traditional groups. In most parts of the country, particularly the Highlands, traditional status within the group is achieved. It is based on the ability of an individual to redistribute wealth—especially pigs, yams and other goods—among (usually) his followers, especially for ceremonial occasions such as birth, marriage and death. Another major venue for achieving status is in competitive feasting between groups, often as a means of compensation following intertribal conflict or misunderstanding. The men who provide the resources for such occasions are known as Big Men, and they do this with the understanding that the resources, as well as interest on them, will be returned to them when they next require such assets for competitive redistribution. Both the status of the Big Men and their group depends on their performance during such occasions. Status is therefore achieved through aggressive acquisition and redistribution of resources, often in the context of conflict or as the sequel to highly ritualized warfare.

The Stunting of the State. This fragmentation and competition has been translated into the modern political system and has led to an extreme disjunction between the formal and pragmatic rules for behavior. Members of Parliament represent constituencies averaging approximately 40,000 citizens and government is constituted by formal political parties for a five year term. In fact, the traditional understandings which still dominate PNG life and the first-past-the-post electoral system militate against the effectiveness of the state. This electoral system consists of a single round of voting with the individual receiving the most votes declared elected. Often forty or more people run for a single office, with election possible with less than ten percent of the vote. The system encourages candidates to achieve power and status by using traditional methods. As election is possible with a small minority of the vote, candidates concentrate on mobilizing support among the restricted range of the total electorate represented by their own social group. Campaigning is based on traditional redistributive relationships, with the leader providing resources to traditional supporters (nowadays including cash and beer as well as more traditional items). In return, supporters provide votes at the election. If elected, the leader then continues the practice of redistribution by providing a continual flow of resources to his followers, while ignoring those who did not support him. This system is recognized and accepted by all, including those who are left out because their candidate was unsuccessful, and it reinforces the fragmentary tendencies of PNG society.

Politics and Governance. Political parties are based on personal allegiance rather than ideology. In turn, allegiance is based on prospects of access to position, such as a ministry, which gives the politician power and access to resources. There are many parties, so Government is necessarily coalition-based. Given the patronage basis of politics, coalitions are fragile and shifting and mass defections from one party to another are common. Votes of no-confidence in governments have become customary, and no PNG government has succeeded in serving out a full five-year term. In this context, governance is weak. The fiscal assets of the state are used to build the strength of parliamentarians, and weaken rivals and rival social groups. National planning is weak and poorly implemented, with implementation decisions often driven by patronage and personalism rather than concerns of sustainable development. Political influence extends to the bureaucracy, with ministers able to hire and fire departmental heads at their whim, further politicizing bureaucratic decisions. Politicians have been given discretionary control over large amounts of the state's fiscal assets in the annual budget, and in recent years these sums ("slush funds") have grown.

9. *Politics as business and politicized public administration are at the heart of PNG's governance crisis.* Together with poor transparency and accountability, the result has been generally poor economic governance, poor public sector performance, mismanagement and a fertile environment for corrupt practices. Corruption has expanded from the traditional form of patronage to unabashed personal enrichment of office holders. It is the latter form of corruption that has particularly alienated large parts of the population from the government, and further weakened the already underdeveloped acceptance of state and nation as key concepts for development.

10. *Lack of transparency in government operations and corruption in the public service were at the forefront of political campaigns during the 1997 elections.* Public commitments were made to improve governance by enforcing greater transparency and accountability in government activities, enhancing public service delivery and curbing the serious crime problem. But the Skate government (July 97 – July 99) was plagued by a series of scandals involving office holders and its commitment to fight corruption and mismanagement was not seen as credible by the public. Original plans to set up an Independent

Commission Against Corruption (ICAC) were dropped as it encountered widespread opposition on both sides of the house.

11. Awareness of corruption and civil society's engagement in the governance process has however increased substantially over the last two years. Notably, a local chapter of *Transparency International* was established in 1997 and its activities are highly visible in the local media. The local press, which reports extensively on the Government's crises and scandals, has increased its coverage of governance issues in general and corruption/anticorruption in particular. Editorials from prominent figures in PNG society are bringing this issue to the forefront of the political debate.

12. *On another matter, the nature of the relationship between national, provincial and local governments has been a long-standing issue in PNG.* The 1995 constitutional amendments on provincial and local-level governments provide for an expansion in the role and responsibilities of provincial and local-level government administration. This legislation devolves significant powers to the provinces in the areas of delivery of services and project implementation. Implementation of this Organic Law continues to be difficult for the provinces whose administrations were inadequately prepared to deal with the impacts of large-scale decentralization. The efforts of the provinces have been further thwarted by slow and partial resource transfers from the central government. Fiscal belt-tightening has been particularly severe in the social sectors for which provincial governments were assigned more responsibility. This has perpetuated the view that "*services are not getting to the people.*"

13. The secessionist war in the province of Bougainville has been widely seen as a threat to PNG's political unity, already weakened by the country's social and political background. The successful conclusion of the Bougainville peace agreement has been a major breakthrough as it ended a conflict that had a debilitating effect on the country's economy. A number of donors are involved in supporting the implementation of the peace plan and targeted interventions in infrastructure and service delivery.

C. ECONOMIC PERFORMANCE, RECENT DEVELOPMENTS AND THE REFORM AGENDA

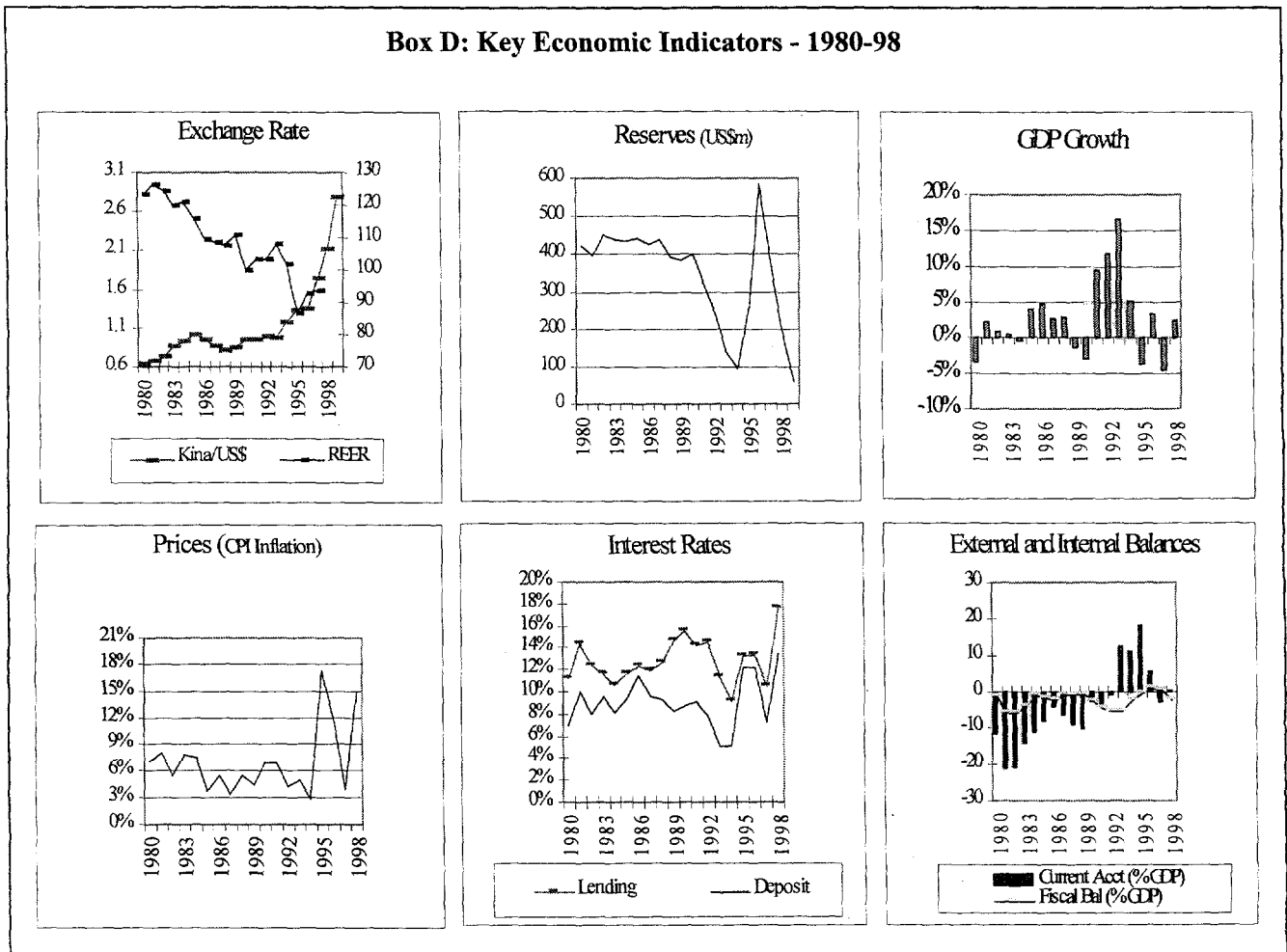
14. *Economic growth in the early part of the decade was driven largely by the construction of large projects and a growing export volume of minerals and agricultural commodities. Government policies have focused heavily on fostering these activities, while little attention has been paid to small holder agriculture and broad-based rural development.* The enclave economy in mining, petroleum, and logging experienced significant but fluctuating growth in output and exports, influenced by prevailing commodity prices and regional economic activity. The overall trend has nevertheless been upward, with an average real GDP growth rate of 4 percent over the 1990-98 period. *However, the impact on the rest of the economy has been relatively minimal, particularly on the informal and small-scale sectors where the bulk of nonagricultural employment opportunities exist.* Growth of nonmineral GDP has not been as robust, averaging 1.5 percent per year over the same period.

15. *In the 1991-94 period, inadequate fiscal restraint coupled with an inappropriate mix of financial and economic policy lead to large fiscal deficits.* These were initially financed by domestic borrowing, resulting in an unsustainable accumulation of domestic debt, dwindling foreign exchange reserves, loss of confidence, and a run on the Kina. Supported by the Bank and IMF, *the Government's adopted an economic recovery program in 1995 which succeeded in reasserting macroeconomic stability.* The fiscal deficit was reduced sharply and developed into modest surpluses in 1996 and 1997. The rate of inflation (based on the consumer price index) declined from over 17 percent a year in 1995 to 4 percent in 1997 while GDP growth reached 3 percent in 1996.

16. *The El-Niño-induced drought of 1997 combined with depressed international commodity prices and the regional economic downturn induced by the Asian financial crisis changed the outlook*

significantly. PNG is now facing its third economic crisis in a decade. It continues to suffer from the consequences of external shocks to its economy. Dealing with these shocks has necessitated major adjustments to the fiscal and monetary programs and policies. Nonmining output dropped by 3.7 percent in 1998 with agricultural export down sharply. Only recently have agricultural exports picked up, at a time of generally less-than-favorable prices. The price of PNG's minerals exports (gold and copper) and forestry products (mainly round logs) have yet to recover from the slump that began in late 1997. The prolonged economic slump in Japan and Korea (the markets for over 90 percent of PNG's timber exports) is delaying full recovery in the forestry sector for quality tropical wood. New and less profitable markets are being pursued in an effort to keep the logging industry from collapsing totally. The recent recovery in the oil sector is a welcome respite from what has been a generally gloomy picture for PNG's export commodities.

Box D: Key Economic Indicators - 1980-98



17. The twin effects of the Asian financial crisis and drought caused a precipitous decline in the country's terms of trade. These events are estimated to have cost around US\$650 million (15.5 percent of GDP) by way of lost export earnings. Overall, the balance of payments fell from a surplus of US\$244 million in 1996 to a deficit of US\$86 million in 1997. Substantial capital outflows occurred in 1998, resulting in a balance of payments deficit of US\$161 million. The expansion of domestic credit underpinned much of the capital outflow and further strained dwindling foreign exchange reserves as the Bank of PNG attempted to slow the depreciation of the Kina. A sharp rise in interest rates has stemmed the flight of capital but has crushed new activities of the private sector. The lending rate was increased to

24-27 percent. At this level, private sector investment is practically nonexistent. Continued weakness of the Kina is limiting the Central Bank's capacity to ease monetary policy. Despite a sharp reduction in import volumes, inflation picked up sharply in the last quarter of 1998. The consumer price index is estimated to have increased by over 20 percent over a year earlier.

18. *Pressures in the external sector necessitated a significant drawdown of foreign reserves which now stand at about 1 month of nonmineral import cover. This development has exerted significant pressure on the exchange rate. The exchange rate, which had settled in a tight band of US\$0.30-0.35/Kina, had been testing new lows in recent months (as low as US\$0.28/Kina). This represents a 45 percent drop from the prevailing rate of US\$0.57/Kina at the end of 1997. The Kina remains at risk given PNG's continued battle with fiscal stability which could lead to new exchange rate pressures as market confidence is further eroded.*

19. *The fiscal response to this crisis has had severe impact on the availability of resources for the major social sectors and development project spending. The Government's expenditures on development projects (including counterpart funding for donor-supported projects) reached only 25 percent of the 1998 budget target. Yet again, PNG's social services and development efforts take a back seat to the pressing need to stabilize an economy that is increasingly incapable of buffering the effects of economic cycles and external shocks.*

20. *The elusiveness of macroeconomic stability is a direct result of PNG's inability to implement and sustain structural reforms that would build a more resilient economy. PNG is a commodity producing country that is confronted with exogenous world prices and production cycles for its commodities. It is therefore critical to reduce the impact of these cycles on both the commodity and noncommodity sectors. Fiscal and monetary policies should therefore aim to be countercyclical. Yet, in most of the cycles over the past two decades, these policies appear to have been procyclical, adding to the amplitude of the cycles. Recent developments in the external environment have further highlighted PNG's inability to buttress economic shocks and the urgency of implementing a long-standing structural reform agenda. As the institutions of governance have weakened, PNG's ability to manage economic cycles and economic shocks has deteriorated, while at the same time amplifying the fiscal and monetary responses needed to pursue stability. The country's capacity to deliver essential services and development programs needed to sustain a higher rate of economic and social growth are impacted by the weakening of the governance framework. A comprehensive structural reform agenda that addresses governance and accountability issues therefore remains at the core of a strategy to reestablish macroeconomic stability and support economic and human development.*

21. *On the fiscal front, expansionary fiscal policies in the early 1990s and the resulting large domestic financing requirements have increased domestic debt ratios. The cost of servicing this debt has increasingly constrained government fiscal options and reduced the ability of PNG governments to utilize the domestic financial sector to cushion shocks to the system. The larger than expected 1998 budget deficit (2.4 percent of GDP) was financed entirely from the central bank. Fiscal performance and overall fiscal management integrity were further weakened by backsliding on a number of policy issues and plain mismanagement, including: (a) substantial unbudgeted and nontransparent expenditures through late-in-the-year payments utilizing the transfer discretion of certain ministers; (b) overestimating certain budget items in the budget presentation which then provides additional discretionary resources that can be deployed to unbudgeted areas late in the year; (c) reducing departmental allocation for goods and services through utilization of lower warrant authorities in order to build a contingency fund, leading to reallocation of badly needed funds from health, education and infrastructure through late-in-the-year nontransparent transfers; (d) making off-budget expenditures through asset sales. Together with a top-down budgeting process, these developments and practices have significantly weakened the budgetary management function over the last 2 to 3 years.*

22. *The budget preparation cycle and financial management processes require concerted adjustments and improvements. The problems and shortcomings represent a range of deficiencies in the governance arrangements associated with the financial management of public funds by core agencies. Some of these deficiencies point to shortcomings or misapplication of legislative arrangements, inappropriate management practices and attitudes associated with the safeguarding of public funds.* This results in a budget and financial management system that lacks credibility and for which there is limited ownership and commitment by line departments that have a significant role in the attainment of budget outcomes. Deficiencies exist along the entire fiscal management chain: budget cycle, cash flow management, commitment/procurement/expenditure system and the overall governance arrangements for the budget. Improvements and adjustments in PNG's fiscal management framework are therefore an important element of the reform agenda. In recent past, fiscal targets have sometimes been pursued by reducing expenditure on goods and services, as well as on development projects. This is neither sustainable nor desirable as key government functions and development projects are effectively stalled. Furthermore, inadequate appropriations for contractual obligations have led to an accumulation of government arrears, particularly to pension funds.

23. In an attempt to redirect government expenditures towards priority areas, new fiscal directions were proposed in the 1999 budget by the previous government. The poor status of the underlying financial management mechanisms undermined these efforts and raised a number of concerns, including: (a) revenue estimates that proved to be overly optimistic; (b) the magnitude, timing and planning associated with the announced public sector retrenchment program that is flawed (grossly underbudgeted with full recurrent expenditure savings factored into the budget); (c) a large increase in the development budget, a significant part of which is to be channeled through Members of Parliament and implemented by the newly established Office of Rural Development which has minimal staff and no implementation experience. *The dichotomy between budget plans and actual implementation must be addressed on a priority basis.*

24. Monetary policy was characterized during the 1980s by the *hard kina* approach, which tended to result in robust foreign exchange reserves and exchange rate stability. This was relatively successful throughout most of the 1980s. Monetary stability deteriorated substantially in the early 1990s in response to successive fiscal crises. *The accommodating nature of monetary policy in the early part of the decade led to excess liquidity in the banking system, and a lessening of the buffering capacity of the monetary system to absorb or mitigate the effects of internal and external economic shocks.* More recently, poor and nontransparent monetary management has further undermined the capacity of the monetary system to assist in economic stabilization efforts. Excesses on the fiscal front have also had a cumulative impact on the monetary system's capacity to act effectively to rapidly changing environments. A major part of the 1998 deficit was funded by bridge finance in the form of temporary advances from the central bank amounting to nearly 3 percent of GDP. Combined with a change imposed by the central bank on commercial bank reserve requirements, this led to a soaring increase in central bank credit to the government, resulting in a breach of the applicable statutory limits. The situation was further aggravated when monetary policy was loosened earlier in the year, leading to a precipitous drop in the exchange rate. Attempts by the central bank to prop up the Kina through direct market intervention failed. The Kina now stands close to its lowest level ever against US and Australian currencies and central bank reserves have been depleted to their lowest level since the 1994 crisis. *The result has been a confidence crisis in the banking system and a complete inability of the monetary system to assist in the stabilization efforts. It is widely acknowledged fact that the conduct of macroeconomic policy has been hampered in recent years by a lack of transparency and accountability in budgetary management, and a blurring of boundaries between fiscal, public enterprises and monetary operations.*

25. Furthermore, there was increasingly inconsistent policy setting by the country's central bank, the Bank of PNG (BPNG). This undermined market confidence in the country's monetary and banking system. A strong and effective central bank is necessary to protect monetary stability and improve the governance of the financial system. The breach in the limit for government borrowing from BPNG is undermining BPNG's credibility, authority and stability. BPNG's independence must be strengthened through amendment of the BPNG Act and new legislation is required to improve BPNG's supervisory powers over the banking sector. Of particular concern has been the apparent lessening of the central bank's ability to pursue independent monetary policy and conflicting signals regarding its stance on monetary policy. The central bank's ability to supervise the newly restructured Papua New Guinea Banking Corporation (PNGBC) has become a serious issue, particularly in a weak governance environment. The new government has committed itself to address these issues.

26. *The impact of poor fiscal and monetary management, combined with continued weakening of the governance environment, has direct and indirect impacts on many facets of PNG life and PNG society.* The forestry sector and associated resource management and ownership issues are a case in point. In response to low market prices for PNG logs, the previous government, in late 1998, effectively awarded the logging industry large tax concessions to keep the industry operating at a level which would generate revenues in hard currency that the country desperately needed. Government led efforts to accelerate the awarding of new concessions in areas where there is opposition to industrial logging have met with significant resistance. Such actions perpetuate the view that the government's short term interests are not compatible with the long-term view taken by an increasing number of clans that forests and the biodiversity that they contain are worth significantly more standing than the one-time landowner royalty they get upon logging. *The pervasiveness of the effects of poor governance on the environment and the resource sector is particularly troubling for a country where 97 percent of the land is communally owned and where land and resource management issues are a constant source of concern within and among clans.* The Bank has formally conveyed its concerns with recent developments in the forestry sector to PNG. Resolution of these issues is being pursued through ongoing dialogue and through the development of a set of conditions that would reestablish a more solid framework for the sustainable use of PNG's forest resources and for the Forestry and Conservation Project (FY00).

27. The forestry sector is but one of the areas where the Bank has supported PNG in the past to implement policy and *structural reforms.* *While some progress has been achieved in a few areas (namely tariff reforms, tax reforms, business legislation and resource management), the agenda for structural reform remains comprehensive. Financial sector and public sector reforms remain top priorities.* The state-owned PNGBC, which accounts for more than 40 percent of banking sector assets, is still subject to government influence in its decision-making, although steps were recently taken to stem further interventions and deterioration of the portfolio. *A key challenge is to improve governance in state-owned financial institutions, setting the stage for full privatization.* It is important to stem the growth of quasi-fiscal operations and improve the transparency of PNGBC's financial dealings in order to build confidence in the financial system.

28. The *public sector* has expanded significantly since independence, resulting in large expenditures on salaries and wages. Unfortunately, these expenditures have not translated into significant improvements in the quality and coverage of basic services or government functions. Periodic retrenchments in the public service have been carried out in times of fiscal crisis, usually with little planning, in order to reduce the fiscal burden. Reform of the public sector is an important issue that is gaining prominence on the political scene as well. *While there is broad-based agreement on the need for a more streamlined and effective public sector, the process by which retrenchments are undertaken has raised numerous issues and greatly affected public sector employee moral.*

D. OUTLOOK AND EXTERNAL ENVIRONMENT

29. *PNG's macroeconomic situation is very precarious and its capacity to carry out its development agenda is strained by the poor fiscal performance of 1998 and first half of 1999. Economic prospects are deemed to be poor to modest over the short to medium term, and subject to a number of external and internal risk factors.* The external outlook shows some small signs of recovery for some of PNG's exports and the agriculture sector continues to rebound from the 1997 drought. An overall real GDP growth rate of about 3 percent has been forecasted by authorities for 1999. This growth would be driven mainly by continued recovery in the resource sector. The nonmineral sector is projected to remain stagnant or further contract slightly.

30. The deterioration in PNG's main export markets raise concerns about its macroeconomic stability in the medium term. The outlook for many of PNG exports are not encouraging, with copper, gold and log prices at or close to their lowest levels in many years. The economy will therefore remain susceptible to some volatility on account of these factors. *The Government's revenue streams from exports, therefore, remain vulnerable in the short term as many commodities seem to have entered a period of price softness.*

31. PNG still faces many hurdles in its efforts to regain control of the economy and reestablish growth. Over the years, PNG has demonstrated an ability to stabilize its economy after periods of crisis. However, *the authority's inability to consolidate these gains through structural reform has hindered the country's capacity to sustain broad-based economic development.* This largely explains the successive rounds of macroeconomic stabilization efforts. Structural reform is urgently required to make PNG's economy more resilient to domestic and external shocks, as well as to make it more adaptable to the dynamism of global economic circumstances.

32. *A critical short-term issue for the Government is therefore to secure external financing.* These funds would be used to rebuild reserves, reduce short-term debt to the central bank and support the government's fiscal operations. External financing is therefore required in 1999 and in 2000 as well. *A related risk is associated to the country's ability to establish and maintain a transparent fiscal discipline for the 1999 and 2000 budgets and prevent the present situation from growing into a full-fledged financial crisis.* Continued local financing of budget deficits would result in a crowding out of credit to the private sector, further discouraging private investment. *Achieving fiscal balance therefore remains an important objective for the country.* A more sustainable fiscal situation and a replenished reserve account would allow authorities to stem the fall of the Kina in an attempt to reduce inflation and allow for an expansion of credit to the private sector. This could set the stage for the stable environment needed to stimulate investments and non-mining economic growth.

E. PAPUA NEW GUINEA'S DEVELOPMENT CHALLENGE

33. The impact of years of mismanagement and bouts with macroeconomic instability has taken a toll on the country's social welfare and developmental progress. Falling health indicators and slow progress in education, compounded by worsening crime and poor infrastructure, have occasioned a diminution of living standards, especially among the most vulnerable groups—namely women and children. Poverty in the rural areas is a direct consequence of these problems. The link between persistent poverty, inadequate primary health and education services and poor infrastructure has long been recognized in PNG.

34. *PNG's major objective over the next three to five years is to reverse the declining trend in living standards and begin improving the quality of life of Papua New Guineans in a tangible and measurable way.* Increased budgetary allocation to social sectors is not in itself sufficient to improve service delivery and alleviate poverty. A real, open and transparent commitment throughout the service delivery chain,

from the initial planning steps right through to the service provider at the provincial and local levels is required to make tangible progress.

35. In their efforts to develop a modern economy, recent PNG governments have set aside, for the most part, the more difficult business of building the key elements and institutions needed for a strong and stable nation in favor of more visible resource development projects. While PNG will celebrate its 25 years of independence in 2000, there are still political and constitutional issues (basic pillars of development) facing the country that require the full and immediate attention of elected officials and PNG citizens. The fragmentation of the sociocultural structure and competition among clans and ethnic groups has been translated into the modern political system, leading to an extreme disjunction between the formal and pragmatic rules for behavior. The intensity of this competition has been one of the main factors increasing the severity of the governance issues now facing the country. A new electoral system that gives elected officials an incentive to respond to the needs and wishes of all their constituents is being publicly discussed and its merits are increasingly recognized.

36. The growing law and order problem is undermining economic activity and an already fragile social cohesion. A stronger foundation must be established for law and order in the country. The government must provide public security and protection of its citizens and must show leadership in complying with constitutional and legal rules and norms. Law and order issues must be made a priority at the political level and concerted strategies developed and implemented with civil society participation.

37. PNG needs to rethink the political and administrative structures outlined in the 1995 Organic Law on Provincial Governments and Local-Level Governments. These changes were intended to support the decentralization of government functions for a more accountable and transparent management by local decision-makers in direct view of their constituents. But there are severe structural problems with the reforms as they have been approved, and transparency and accountability are further undermined. The continued excessive centralization of decision-making, the non separation of political accountability and administrative control and ad hoc jurisdictional boundaries are cases in point.

38. Improved economic governance and a better capacity to buttress internal and external shocks are critical elements of a concerted social development strategy. Enhanced service delivery, investment in human capital and rural infrastructure are needed for an improved quality of life in PNG. This will only be possible with a stable macroeconomic environment and a more effective public sector. Combined with a more effective decentralization strategy, this should have a direct impact on service delivery. PNG's problems are not unique, though they are more extreme than those faced by many countries.

39. *PNG's development challenge is, therefore, to improve the overall governance framework and accountability mechanisms, with the objective of implementing an effective and equitable allocation of the country's financial resources to priority social areas while supporting the creation of an economic environment that is supportive of agricultural development and private sector-led growth.* For it to be effective, the country must find a way to address political and constitutional issues in a timely and constructive manner. There must be a concerted effort by Papua New Guineans for Papua New Guineans to solidify the foundation of their young nation on which sustainable economic and social progress can be achieved. The Bank and other development partners can support these efforts but cannot lead them.

2. PAPUA NEW GUINEA'S DEVELOPMENT AGENDA

A. PAPUA NEW GUINEA'S MEDIUM-TERM DEVELOPMENT STRATEGY

40. Papua New Guinea has a well-articulated statement of its development objectives, actions, and development targets. This strategic outlook is set out in PNG's Medium-Term Development Strategy 1997-2002—A Bridge Into the 21st Century. The Medium-Term Development Strategy (MTDS) outlines the Government's new vision for itself, the country and its people. The MTDS also outlines priority programs and projects. Box E provides an overview of the MTDS, its strategic elements and program priorities. Although the present government did not draft the MTDS, it has declared its intentions to revive the strategy by implementing the guiding principles of the MTDS through its economic and human development programs.

Box E: PNG Medium-Term Development Strategy (1997-2002)

The Medium Term Development Strategy (MTDS) for the 1997-2002 period was presented to Parliament in December 1996 and provided the backdrop for the 1997 budget. The strategy is based on the following seven elements:

- (1) **Adhering to, and strengthening, the policies begun under the 1995 Structural Adjustment Program**, including: (a) maintaining a stable macro-environment; (b) improving international competitiveness; (c) improving the environment for private sector investment; (d) maintaining sustainable and equitable policies for using natural resources; (e) improving public expenditure management and control; (f) improving the effectiveness of public expenditure; and (g) reforming taxation, tariff, investment and trade policies generally in the direction of increased liberalization.
- (2) **Focusing program and budget expenditures on priority areas**. For health, this means focusing on: (a) preventive and rural health service delivery; (b) raising the standard and numbers of healthcare workers; improving administrative efficiency; restoring and upgrading buildings and equipment. For education, this means: (a) setting and implementing appropriate curricula; (b) raising teacher numbers and standards; (c) upgrading buildings and equipment; (d) reducing administrative costs. For infrastructure, this means: (a) immediately restoring existing infrastructure to tolerate conditions and regular maintenance afterward; (b) planning and constructing new infrastructure where appropriate; (c) rationalizing current departmental structures; (d) clarifying responsibilities of various levels of Government. For private sector development, this means: (a) increasing access to appropriate credit facilities; (b) improving access to extension, training and development services; (c) increasing research activities that increase productivity; (d) monitoring and surveillance of commercial activities. The Government's strategy to address governance and law and order issues entails: (a) raising the level of public awareness, especially in the rural population; (b) encouraging grassroots participation to help people define and articulate their own demands and priorities, and to hold their representatives and the Government accountable for policies and decisions; (c) moving to a merit-based civil service; (d) reforming laws and institutions that facilitate potentially corrupt behavior such as patronage and nepotism in favor of *antoks*; and (e) setting an example at the very top level of leadership to remain corruption-free and to fight against bribery and political and financial kickbacks, with a view to promoting nation-building and accountability of all politicians.
- (3) **Strict application of productive and priority criteria for projects to be funded**. A new set of investment principles will be applied consistently across the Government's investment program, the PIP. Projects must comply with stated policy priorities, be productive and sustainable.
- (4) **Enhancing the resources available to Government** through more effective enforcement of the existing tax regime, including increased attention on the collection of import duties. The introduction of the Value Added Tax in 1999 is a major step in broadening the tax base.
- (5) **Redefining the roles and functions of Government**. This will require a fundamental reform of the public sector with the objective of improving performance in policy implementation while reducing costs.
- (6) **Repositioning the private sector as the engine of economic growth**. Increased Government spending is not a substitute for the more broad-based growth that would flow from a private sector-driven growth. The Government must therefore make it easier for the private sector to conduct its business.
- (7) **Carrying through the provincial reforms begun in 1996** and working with provinces to ensure harmony and balance between national, provincial and local priorities for expenditures. This involves accelerating the devolution of authority as a cornerstone of improved service delivery at the local level. This will require significant improvements in fiscal planning and performance monitoring at provincial and local levels.

41. The MTDS is supported by a medium-term resource framework that lays out the Government's tentative plans for expenditures in the priority areas of health, education, infrastructure, private sector development and law and order. The MTDS provides a comprehensive roadmap for development in PNG. It is an ambitious program focused on improving the welfare of the population and stimulating the economy. The objectives are laudable and consistent with the Bank's views regarding development objectives and priorities for PNG.

42. The needs, priorities and strategies for PNG's social and economic development are reasonably well laid out for most sectors, providing the Government and donors with a framework to develop and implement development programs. For example, the National Health Plan provides the overarching framework for implementation of the Government's health initiatives and donor-funded development programs. *Regardless of the clarity of objective and purpose, the development strategy is only as good as the Government's capacity and determination to implement it in a consistent and transparent manner.* So far, objectives of the MTDS have largely failed to be achieved.

B. PNG'S PARTNERS IN DEVELOPMENT

43. PNG mobilizes substantial assistance from the international community. PNG's largest trading and development partner is Australia. Through the Australian Agency for International Development (AusAID), Australia supports a wide range of programs. Annual grants are of the order of US\$200 million.

44. Japan, the European Union and New Zealand also assist PNG. A number of United Nations agencies, particularly UNDP, are active in the country, supporting a wide range of technical assistance programs. Overall, annual grants to PNG amount to about US\$60 per capita. Lending from multilateral organizations, namely the ADB and the Bank, adds, on average, another US\$15-25 per capita per year. By any measure, the assistance afforded PNG is substantial. A comprehensive listing of ongoing and pipeline projects on a sector-by-sector basis is provided in Attachment 2. A more concise overview, along the lines of the Comprehensive Development Framework, is provided in Box F.

45. *Donor coordination is increasingly important for PNG.* Transition of the AusAID program from general budget support to project financing will soon be completed and the ADB has outlined an ambitious lending program for the next three years. Combined with growing programs from other bilaterals, the limited local capacity to manage donor programs and implement projects is being stretched to the limit. The strain is showing and project implementation performance has weakened substantially in the last few years. This situation is further exacerbated by the difficult fiscal environment and low priority given to counterpart funding. The Bank has highlighted the importance of improved foreign aid management and encouraged PNG to implement the recommendations of the Foreign Aid Management Review conducted under an ADB technical assistance activity in 1998. In this spirit, the Bank has encouraged PNG to adopt a comprehensive development approach in the strategic planning of foreign aid in order to achieve more effective targeting of donor assistance. This would provide donors with an important tool to better coordinate their efforts and maintain a more strategic and programmatic dialogue. The ultimate objective is to improve the overall effectiveness and development impact of donor-supported activities. With the prospect of improved donor-supported program coordination, the PNG Government and donors alike are looking forward to the next Consultative Group (CG) meeting to help consolidate the coordination function. The Bank is also considering a request for technical assistance to support the institutional capacity development of the Office of National Planning and Implementation.

Box F: Involvement of Development Partners in PNG's Reform and Development Agenda		
Prerequisites for Sustainable Growth and Development (from Comprehensive Development Framework)	Focus of the Government's Reform Agenda	Engagement of Multilateral and Bilateral Institutions
Structural		
Good and Clean Government	In the MTDS. Includes public sector reform, improved transparency, addressing corruption, and effective decentralization	Australia, UN Agencies, ADB, World Bank
Justice System (including law and order)	Included in the MTDS	Australia, New Zealand, EU
Financial System	Not an explicit focus of the MTDS	Australia, World Bank
Social Safety Net and Social Programs	Not yet a concern in the PNG context	
Human		
Education	A stated priority, although delivery is a major issue	Australia, New Zealand, ADB, UN Agencies, World Bank, EU
Health	A stated priority, although delivery is a major issue	Australia, New Zealand, UN Agencies, ADB, World Bank, EU
Physical		
Water and Sewerage	Not an explicit focus of the MTDS	Australia, ADB, Japan, EU
Energy	Not an explicit focus of the MTDS	
Roads, Transportation and Telecommunications	Included in the MTDS	Australia, Japan, ADB, World Bank, EU
Environment and Cultural Issues	Included in the MTDS	ADB, UN Agencies, World Bank, GEF, EU
Specific Strategies		
Rural Strategy (including agriculture)	Not in MTDS but recent focus in 1999 budget	Australia, New Zealand, ADB, World Bank, Japan
Urban Strategy	Not an explicit focus of MTDS	Australia, Japan
Private Sector Strategy	Indirectly, through MTDS objectives for economic management	Australia, ADB, World Bank, EU

46. The Bank has recognized the importance of strengthening donor coordination and is taking measures to assist PNG in this regard. The Bank has for instance, revived the CG process, and engaged PNG in a dialogue regarding a CDF-type approach to donor aid coordination. Furthermore, the Bank, AusAID and ADB have established a more sustained dialogue through semiannual tripartite consultations. Joint sector work was carried out in the health sector with AusAID. Cofinancing arrangements are under discussion with ADB and Japan's Overseas Economic Cooperation Fund (OECF) for the Highlands Highway project. Partnership and coordination also include recognizing each agency's comparative advantages and respective roles in the various sectors. The Bank has organized joint sector reviews with ADB and AusAID to arrive at a common understanding of sectoral needs. The Education Sector Review was the first in what is hoped will be a series of joint studies. Cooperation with key donors, including international non-governmental organizations (NGOs), will be further increased as a basis for development partnerships. The next step involves joint project performance implementation reviews as was undertaken during the recently concluded Country Portfolio Performance Review.

C. CIVIL SOCIETY'S VIEWS AND ASPIRATIONS: A VISION FOR PNG

47. Sustainable economic and social development requires broad-based stakeholder participation in the definition of the development agenda and ownership of the implementation plan. The Bank initiated a consultative process with PNG's civil society to: (a) involve a broad range of stakeholders in the articulation of development priorities and strategies; (b) appraise civil society of the framework for future Bank intervention and the context of its Country Assistance Strategy, and; (c) establish a framework for

more regular consultations. This process builds on a series of informal meetings since 1995. A brief overview of the mechanism and results of the consultative process is provided in Attachment 3.

48. PNG's development agenda has not changed markedly since independence, an indication of relatively weak performance in implementing social programs. What is beginning to change, however, is society's role in defining and implementing the development agenda. The "hand-out" and "cargo" mentality is beginning to change, with people and organizations wishing to play a much more active role in implementing programs that benefit themselves, their families and communities. This development has occasioned a very sharp rise in the number of NGOs, community-based organizations (CBOs) and church groups active in social service delivery, particularly in the last decade. These groups and organizations are playing an increasingly important and essential role in the delivery of social services to the people. They are also providing a vision for the future that is more in tune with the wants and desires of the population at large. The Bank's consultations provided a setting to explore a vision of PNG in a 15-20 year timeframe as presented in Box G. This vision proposes the enhancement of village life via increased and equitable investment in human development and infrastructure, employment promotion and a strengthening of social order and cohesion. Effective implementation of the MTDS would go a long way in supporting this vision.

Box G: A Vision Statement for Papua New Guinea

The cornerstone of the vision for Papua New Guinea is to enhance village life so that it provides its inhabitants with a caring environment that emphasizes human development that is considerate of people's traditions and the natural environment.

Enhanced village life would:

- encourage young villagers to pursue educational, work and life experiences in their native village, thereby reducing migration to urban areas and the associated social and urban decay;
- provide increased opportunities to participate in the cash economy as one element of a broader trade and commerce setting, with particular emphasis on agriculture and sustained use of natural resources;
- provide a constructive setting for social and economic development to occur that is considerate of people's wishes and desires; and
- provide easy access to basic health and social services that are necessary to sustain a productive and cohesive population.

On the education front, this means that universal basic education is achieved and a broader range of options is provided (beyond the conventional route) in technical and vocational training, important elements of skills enhancement leading to increased employment opportunities, both in the formal and informal sectors. Providing opportunities to the country's youth is at the center of any improvement in the law and order situation, another important objective in the medium and long term.

On the health front, this means increased access to basic health services, particularly reproductive, maternal and infant health. Health services need to emphasize prevention as the cornerstone of improved health management in the country, including access to safe drinking water in the rural areas. Improved gardening practices and produce diversity should contribute to better nutrition and market opportunities for excess products.

On the employment creation front, this means an expansion of the agricultural base in terms of overall productivity and into other areas, including forward integration into conversion, packaging and distribution. Manufacturing and secondary production in the resource areas would also provide employment and business opportunities.

The delivery of services and increased commercial activity need to be supported by a solid infrastructure framework, particularly roads that allow villagers to deliver products to local and regional markets and facilitate the flow of products and services.

Clan and community decision-making must form the cornerstone of the development process and the basis for the establishment of a tradition of sustainable use of natural resources. This model for decision-making should lead to a better partnership between society and the Government, leading to improved transparency and accountability.

3. BANK GROUP COUNTRY ASSISTANCE PROGRAM

A. PROGRESS TOWARD OBJECTIVES OF THE PREVIOUS CAS—AN UNFINISHED AGENDA

49. The previous CAS, endorsed by the Board of Executive Directors on August 29, 1995, envisaged two possible scenarios for the Bank's involvement in PNG. Under the reform case, the Government was expected to stay the course on reform implementation, improve service delivery, and step up implementation of donor-funded projects. Under this scenario, the FY96-98 lending program would have been in the range of US\$140-160 million in two adjustment and three sector investment operations. The low case assumed that there would be no or little continuation of policy reforms after the 1995 Economic Recovery Program (ERP) loan was fully disbursed and that portfolio implementation remained unsatisfactory. In this case, the three-year lending program would drop to US\$70-80 million.

50. Final implementation of the ERP loan was delayed by about a year. Slippage and backsliding on policy issues were the main reasons for the delays. Since then, there has been only one lending operation, the El-Niño Drought Recovery Project (US\$5 million), which was presented to the Board in April 1998. The three-year lending program therefore amounted to US\$55 million. An emergency operation was organized in 1995 after a volcanic eruption devastated the provincial capital city of Rabaul on the Gazelle Peninsula of East New Britain Province. This operation was funded through the reallocation of funds from existing loans that were not performing well and did not entail any new lending.

51. **What Worked.** Some progress was made toward achieving certain objectives of the 1995 CAS, although recent developments have erased some of these achievements. Some of the more notable achievements and developments over the last CAS period include:

- Stabilization of the economy until the drought and the Asian financial crisis hit in 1997. As important, the government has gained a better understanding of the potential benefits of structural reforms and is taking a more active role in developing the reform agenda;
- A new form of project implementation approach was developed, tested and proven effective in the PNG context. The new implementation framework emphasizes accountability at the provincial level under the leadership of an independent agency, effectively a regional economic development approach under strong management leadership. This has resulted in stronger project ownership, solid implementation performance and, above all, good prospects for sustainability;
- Substantial progress was made in the forestry sector by enhancing transparency and accountability in the management of these resources. This was achieved by strengthening the independence of the National Forestry Board, adoption of sustainable-cut criteria, improving the code of conduct and ensuring a fairer return to both the Government and the landowners. Continued dialogue in the forestry sector during the preparation of the Forestry and Conservation Project also provided for sustained engagement on the policy front.

52. **What Didn't Work and Lessons Learned.** *Notwithstanding the above, overall progress has been marginal at best.* Of particular concern has been the accelerated deterioration of economic governance, characterized in part by backsliding on a number of substantive issues and continued lack of transparency in fiscal management. Sustainability is therefore an important issue in the PNG context. The Bank's PNG portfolio has been a consistently poor performer since 1996. Recent experience has clearly demonstrated that there is a need for continuous focus on implementation performance and capacity building. Portfolio management efforts have been inadequate and must be strengthened substantially to rebuild the implementation environment that once existed. The poor implementation performance is also increasingly apparent in the post review of completed projects.

53. In the last five years, the Operations Evaluation Department (OED) has evaluated ten projects and rated the outcome of seven of these projects as unsatisfactory. The operations reviewed rated as having modest institutional developmental impact while their sustainability was very uncertain. In retrospect, the preparation of these projects appears to have been inadequate and their design sometimes too complex. More recently, OED completed a Country Assistance Evaluation (CAE) for PNG. OED concluded that: i) the development outcome was unsatisfactory; ii) institutional development impacts were modest; iii) sustainability was uncertain, and; iv) overall Bank performance was mixed. OED has also made recommendations on future Bank assistance to PNG. The Bank's CAS incorporates many of the recommendations from this review. OED's recommendations are outlined in Table 2.

Table 2 - OED Recommendations and Bank Strategies

OED recommends that the Bank:	Bank Strategy Responding to Recommendation
- should sustain its non-lending services	The non-lending program for FY00-02 represents a comprehensive program supporting basic knowledge development, sector strategies and economic analyses focusing on the core issues of governance and rural development while at the same time investing in portfolio improvement efforts. The budget allocation for non-lending activities is larger than for new lending operations.
- collaborate with GOPNG and other donors to develop a long-term strategy along the lines of the CDF	The November 1999 Consultative Group Meeting for PNG will provide the opportunity to initiate the strategic planning process along a CDF framework. The Bank will support follow-up work through the Office of National Planning and through the existing tripartite consultation process.
- help manage existing resources rather than provide additional financial resources	The low-case lending program is small and highly focused. The base-case is anchored in an adjustment operation that will set the stage for reforms supportive of more accountable and transparent fiscal and monetary management. Follow-up sector interventions would deepen the structural reforms and support their sustainability. On-going dialogue on governance and economic management issues will underpin efforts to help PNG improve its fiscal management and overall effectiveness.
- establish a field presence	The Bank established a Liaison Office in PNG in 1996 and recently appointed a coordinator to enhance day-to-day dialogue with GOPNG and development partners. A regional presence is under consideration and, should it eventuate, would further enhance the Bank's dialogue with the country.
- disseminate objectives to build ownership	The Bank will build on its extensive consultation experience acquired during the preparation of the Forestry and Conservation Project. The Bank will develop and implement a communications program that will convey the Bank's role and responsibilities in PNG. This effort will be initiated during the November 1999 CG meeting which will be taking place in Port Moresby. Furthermore, through an enhanced presence in PNG, the Bank will organize broad consultations with stakeholders regarding the structural adjustment program.

B. THE COUNTRY ASSISTANCE STRATEGY

54. *The overarching goal of the PNG CAS is to support a concerted effort to reduce poverty and improve the quality of life of Papua New Guineans. The primary objective for this CAS period is to assist PNG in strengthening the foundation for a capable state that can be responsive to its people by addressing human and economic development challenges in a transparent and accountable manner. The Bank's capacity and ability to contribute to this ambitious objective will depend to a great extent on PNG's commitment to these objectives, both in spirit and in practice, and on the level and effectiveness of engagement of other donors.*

55. *Bank development assistance to PNG (in resource terms) has traditionally been significantly less than that provided by Australia and Japan. Compared to other sources of official development assistance, IBRD funds can appear as being relatively expensive. Furthermore, Bank procedures and rules are often perceived as being unduly restrictive by some national departments and agencies that deal with the Bank's procurement, disbursement and financial management requirements. Furthermore, our recent focus on adjustment lending and macroeconomic dialogue has, in certain quarters at least, created an image of Bank lending that is burdened with numerous conditions and overly directive in setting government policy.*

56. *Nevertheless, the Bank has, for the most part, been accepted by the Government, members of PNG's civil society and the donor community as a valuable advisor that can bring together substantial amounts of expertise, resources and credibility. Nonlending services have been an important part of the Bank's work program in this regard and will continue to form the basis for ongoing dialogue in a number of sectors. It is against this background that the possibility of limiting the Bank's role in PNG to the provision of non-lending services was considered. The Government and other donors are desirous of a continuation of the Bank's lending program, which is seen as a firm basis for effective policy advice and structural change. The provision of non-lending services alone is not considered a credible substitute for lending operations, although it remains a distant possibility should the dialogue with the country deteriorate significantly and implementation performance worsen even more.*

57. *The CAS objectives will be pursued through the implementation of an operational strategy that will support: (a) improvements in the governance framework for sustainable development, and; (b) enhanced rural development. The underlying elements that support these strategic objectives are outlined below. The need to focus on governance issues is overwhelming. The basic public sector operations intended to provide services to rural areas are not working properly. Poor service delivery is not due to a lack of government financial resources, but is a direct result of public sector mismanagement, poor accountability mechanisms and unwillingness to make service delivery a priority in practice. Improved governance is at the core of the service delivery challenge and it must be pursued through a judicious set of policy and public sector reforms. The effectiveness of sector lending and development assistance in general is dependent on it.*

58. *Because the vast majority of PNG's poor live in rural areas and derive their livelihood from traditional semi-subsistence or subsistence agriculture, broad-based rural development will be key to alleviating poverty. There continues to be untold suffering and lost human potential in rural areas because of poor health services, limited educational opportunities, difficult or no market access and limited economic and employment opportunities. A truly comprehensive development strategy must therefore address the needs and aspirations of the rural population.*

59. *This agenda will be pursued while recognizing the importance of establishing and maintaining a stable macroeconomic environment and a sound financial system in order to support sustainable growth. It is however worth noting that this program demands unflinching commitment on the Government's part, transparency and consistency in policy implementation, and accountability of government officials. PNG's checkered history of policy implementation must be improved if this effort is to succeed. Additionally, since this agenda is long-term in nature, the full benefits will not be realized during the life of this County Assistance Strategy (CAS). The Bank's support, therefore, aims to create a viable (and appropriate) foundation for successful reform in the medium and long term.*

60. The lending and non-lending activities in this CAS have been formulated on the basis of the following considerations: (a) PNG's development needs, priorities and views on how and where the Bank can make a contribution to its development program; (b) the *Bank's comparative advantage* vis-à-vis those of other donors in sector or country-specific areas; (c) the Bank's operational experience in PNG and lessons learned from recent project implementation failures and successes; (d) the country's implementation performance at both policy and project levels; (e) the Bank's role and responsibility in promoting responsible environmental management and global environmental protection and conservation. In this context, *Bank lending for macroeconomic and structural reform continues to be an important area of intervention. Without a stable macroeconomic environment and effective implementation of essential structural reform, the developmental impact of most projects in PNG would be limited and unsustainable.* Donors have repeatedly affirmed their expectation that the Bank will continue to be active in this regard, and that a strong structural reform program would constitute the basis for some of their own interventions.

61. *PNG is at a crossroads, at a point in its development where targeted Bank support could make a significant contribution to economic and social development efforts.* The Bank would support an engagement level that is commensurate with the challenges now facing PNG but the partnership must be further strengthened in order to support a more substantive engagement. *On this basis, the Bank's CAS program is therefore cautious and focused. The PNG program is presently operating on the basis of the low-case lending scenario. A more comprehensive lending program is envisaged should tangible progress be achieved on the structural adjustment front and ongoing project implementation difficulties are properly addressed. Base-case triggers are presented in Table 2 (page 26). The achievements over the CAS period will depend greatly on the capacity of the country to implement the basic actions needed to lift the PNG program into the base-case lending scenario.*

Improving the Governance Framework for Sustainable Development

62. The structural reform agenda is substantive. Public sector operations and programs must be conducted more efficiently and more cost-effectively. The reforms must lead to better management of the Government's financial resources for the benefit of its people. The service delivery chain, from planning to implementation, needs an overhaul. The overall governance framework must be strengthened so that the country's resources and development assistance are used more effectively and lead to more tangible development outcomes and poverty alleviation. The recently completed Country Economic Memorandum provides a comprehensive analysis of opportunities to improve the governance framework and, ultimately, overall performance.

63. **Improving Governance and Accountability.** The new Government has repeatedly and publicly expressed its commitment to improve its efficiency and to change procedures and practices that provide opportunities and the foundation for corrupt and non-transparent practices. This is a stated objective in the MTDS. *The Bank stands ready to support the development and implementation of policy reforms that will begin addressing the core issues affecting the good conduct of fiscal and monetary policies.* In addition to supporting the balance of payment, the policy-based operation would be developed to support

implementation of structural changes under the Government's reform program. This would strengthen the capacity of the state to reduce mismanagement and opportunities for corruption through a range of institutional reforms. *Successful implementation of this operation would be followed by targeted interventions dealing with issues of operational efficiencies that have a direct impact on the Government's capacity to deliver social services through a decentralized framework.* This would include the Public Sector Reform/Civil Service Development project and the Financial Sector Reform project. Effective devolution of responsibilities to the provincial and district level and increasing alternative service delivery mechanisms through NGOs and religious organizations will reduce the discretionary powers of politicians and bureaucrats, thereby minimizing the scope for abuse of public office. The Structural Adjustment Loan (SAL) would also address key issues affecting the effectiveness of decentralization efforts.

64. An important element of the governance agenda relates to efforts to improve the law and order situation. PNG has seen substantial growth in crime in recent years. The problem is getting worse with serious crime doubling in the last ten years. Continued AusAID support in this area will remain critical over the foreseeable future. As stated earlier, the situation must be made a priority by the government and dealt with as one of the basic pillars of nationhood.

65. **Fiscal Management.** The budgetary process has essentially collapsed over the last 18 months, and there are serious deficiencies in the governance arrangements associated with the financial management of public funds by core agencies. Reforms will need to address the budget cycle, cash-flow management system, commitment/procurement/expenditure system and the overall governance arrangements for the budget. Improved fiscal management and more transparent administration of public funds will be targeted through the Bank's lending and nonlending activities. *Overall governance can be improved by strengthening fiscal management, supporting and adequately funding institutions entrusted with fighting corruption, and reforming the legal and regulatory framework governing the use of natural resources.*

66. **Public Sector Reform and Civil Service Development.** *Improving the effectiveness of the public sector is an important element of the service delivery strategy.* Training opportunities have been provided under the Public Sector Training project (essentially a capacity-building effort), but more in-depth reforms are needed to increase the productivity and effectiveness of the public sector to manage the nation's resources, while at the same time improving the delivery of public services to its citizens. Elements of the reform may be pursued through the SAL, and a more comprehensive program will be initiated through the Public Sector Reform/Civil Service Development project. This project will complement a sizable program under preparation by the ADB. Capacity development efforts would also be supported in the resource management sectors where the country has much to gain by increasing the efficiency of its resource management and revenue collection efforts. Successful implementation of the Petroleum Development Technical Assistance project (closing in FY01) has provided a framework upon which new technical assistance operations are being designed for the mineral (FY00) and gas (FY01) sectors.

67. **Macroeconomic and Business Environment.** Macroeconomic stabilization and broad-based economic development objectives will be pursued through continued dialogue with the Government and the implementation of an adjustment program in close collaboration with the IMF. This program will support the Government's efforts targeted at: (a) reestablishing and maintaining a sound and stable macroeconomic environment; (b) improving the business environment in support of private investment, and; (c) promoting a sound and efficient financial sector.

68. A sound and stable economic policy environment reduces the cost of doing business and encourages private investment. A macroeconomic environment that consists of a well-conceived mix of

fiscal and monetary policies which enhances proper planning and implementation of essential social and economic services is of equal significance. The promotion of private sector development through the elimination of discretion in granting of tax exemptions, tariff and excise tax reform, and the removal of cumbersome regulations for foreign investment are high priorities. Strengthening revenue performance in the natural resource sector will also help sustain the flow of benefits from the oil/gas and mining projects to the rest of the economy.

69. It is important to recognize that only a very small portion of the population is employed in the formal sector and that, in the short term, development and expansion of the private sector will provide few opportunities for the rural population. Furthermore, many of the opportunities that are created in the private sector require skills and expertise that are not easily found in PNG. *Broad economic development in the PNG context will not significantly help the lot of the poor unless it is underpinned by a concerted rural development strategy.*

Supporting a More Effective Rural Development Strategy

70. **Improved Delivery and Effectiveness of Basic Services.** Improvements in health, education, agriculture and infrastructure are mutually reinforcing. Improvements in the educational status (especially of women) would support reform efforts in the health sector by facilitating awareness, immunization campaigns and better child nutrition. The provision of better health services, improved access to health facilities and greater awareness of reproductive health issues improve the quality and productivity of the work force, as well as living standards. Basic infrastructure enhances the social and economic well being of PNG citizens by improving accessibility and affordability. The intricacies of the “poverty/service delivery/infrastructure” nexus demands a comprehensive approach to economic and sector reforms. Therefore, the Bank supports improved service delivery, legislative/regulatory reform and capacity-building in the medium term as a platform for more substantial reform programs in the longer term.

71. **Health.** To overcome the poor health status in PNG, the Government needs to take bold steps to improve the effectiveness of its administration, particularly at the provincial and local levels. The Bank’s only operation in the health sector is the Population and Family Planning Project (PFPP), which focuses on reproductive health, generation of demographic and health data and operations research to guide socioeconomic planning and program evaluation. The PFPP is cofinanced with ADB and AusAID and will be completed in FY00. Since the early 1980s, ADB has been the lead donor agency in the health sector through a series of rural health projects and, lately, a health sector adjustment loan. AusAID is financing projects on a grant basis. Absorptive capacity would stand in the way of further Bank lending. The Bank’s strategy is therefore to: (a) conclude implementation of the PFPP and ensure its sustainability; (b) continue dialogue with both the Government and donors active in this sector to bolster the Government’s commitment to improve the coverage, reliability, and quality of health care, especially for vulnerable groups in rural areas, and; (c) support improvements in the administrative aspects of resource flows to the health sector through improved fiscal planning/management and public service reforms at both the central and provincial government levels.

72. **Education, Training and Capacity Building.** The Bank has supported education and capacity development with five loans since 1975, two of which are ongoing: (a) the Education Development Project, which supports the National Education Reform through the provision of textbooks, the maintenance of secondary-level schools and the strengthening of education planning and management procedures; and (b) the Public Sector Training Project, to foster the implementation of the National Training Policy through strategic planning for training and financing local and foreign fellowships for PNG nationals in key policy, planning, and technical areas not available in PNG. There is consensus, both within the Government and in the donor community that continued Bank involvement in the sector adds substantial value. *The size and scope of this support would be determined following the completion of the*

investment plan related to the sector review and performance in completing the implementation of the Education Development Project which was recently extended for a three-year period.

73. **Agriculture.** Sluggish and uneven agricultural growth has impoverished a large portion of the rural population, created widened disparities in rural-urban income and threatened the stability of the traditional food security and natural resource management systems. *The majority of the population lives in rural areas with communal land ownership, and agriculture provides the most obvious economic development opportunity for a large part of the population.* The importance of environmentally sustainable agricultural growth and a more diversified, competitive and self-reliant production base are articulated in the National Agricultural Plan as the key elements of the Government's strategy. Significant improvements in smallholder productivity of crops and livestock, and greater efficiency in the operation of the commercial tree crop plantations and estates are necessary conditions for achieving this goal. *To exploit the opportunities that PNG's vast variety of agroecological conditions offer, the Government needs to undertake a significant shift in its approach to resource allocation in support of the agriculture sector.* Sustainable improvements in smallholder agriculture are constrained by poorly functioning public sector support services and a limited technology and information base for long-term productivity improvements.

74. Other donors have traditionally taken the lead in supporting the agriculture sector in PNG although the Bank has also had a long-standing presence in this sector. *While the constraints to achieving higher rates of agricultural growth in PNG are generally well understood, identifying feasible interventions—especially for improving smallholder productivity—remains difficult.* Institutional capacity at the sectoral level both in Port Moresby and the provinces is poor. Performance of a number of donor-supported interventions, including the Bank's Oro Smallholder Palm Oil project, has fallen short of original expectations. *Given the crucial importance of the sector to poverty reduction we intend to continue our dialogue with PNG and other donors in an effort to identify ways and means to address the sector development problems. There is a knowledge gap in this sector and the strategic options for stimulating agricultural growth and rural development are not well developed. Analytical work is planned in FY00 to better define a strategy that would stimulate agricultural development in rural areas.* Lending activities would be considered in light of the study findings.

75. **Infrastructure.** Poor road conditions impose significant costs on the economy and undercut the present economic recovery efforts. The development of infrastructure is essential for the delivery of services and is in itself an important element of economic development and employment creation. The Bank has been at the forefront of the policy dialogue on strategies to improve the performance of the road transport sector. Donors and the Government alike have acknowledged the Bank's contribution and it is therefore proposed that the Bank should continue its substantial involvement in the sector. Specifically, the Bank has helped to establish a number of key building blocks for effective planning and management of the road transport sector. *The Bank's strategy in the road transport subsector is to assist the Government with technical, economic, social, environmental, financial and institutional issues relating to policy formulation, implementation and performance evaluation.* This will be achieved in the context of the Road Maintenance and Rehabilitation Project, the Highlands Highway Project, and the continued support of the Gazelle Restoration Authority which has undertaken the reconstruction efforts in East New Britain Province after the 1994 volcanic eruptions.

76. **Environment, Forestry and Conservation.** PNG has one of the last remaining continuous tracts of rain forest left on the planet. Supporting its maintenance is part of the Bank's institutional global mandate and reaches beyond the CAS. This rich biodiversity is at risk from the intensive and destructive logging practices that began in the late 1980s and increased dramatically until the Asian financial crisis. The Bank has been extensively involved in this sector since 1990 and has supported the establishment of

the legal and regulatory framework of the forestry sector. The reforms are intended to achieve a more sustainable use of PNG's forest resources and improve benefits for landowners. Other developments include the creation of an independent National Forestry Board, the establishment of criteria for assessing forestry project proposals, the development of a new export tax and landowner royalty levy system, and the introduction of an independent export inspection and monitoring system. Additional measures will be introduced to promote environmental protection and conservation under the Forestry and Conservation Project. This project will be supported by the Global Environment Facility (GEF). Its hallmark will be the involvement of landowners and communities in the design and implementation of small-scale forestry operations or alternative revenue generating activities.

C. VEHICLES FOR BANK ASSISTANCE

77. **Portfolio Management.** *Improved performance of the existing portfolio remains a top operational priority.* The status of implementation performance is seen as an important indicator of the Government's ongoing commitment to its development agenda and of the capacity that can be mobilized to support the implementation of ongoing and future Bank-financed operations. The status of the portfolio is summarized in Box H.

78. A portfolio performance review undertaken in March 1999 confirmed that the occurrence and severity of systemic issues affecting project implementation performance had increased since 1996. Furthermore, project-level impacts were more serious than before. The nature and causal effect of these issues were analyzed in some detail. Problems identified include inadequate and late counterpart fund release, frequent staff turnover, lack of skilled accountants and ongoing procurement and financial management problems, among others. The necessary improvements to the implementation framework are comprehensive and relatively complex given the prevailing exogenous nature of issues affecting project implementation.

79. *A comprehensive project implementation improvement program has been developed and discussed with GOPNG.* The Bank would increase its focus on in-country implementation mechanisms through several avenues, including: (a) providing advisory services on a business process analysis of the project implementation process; (b) undertaking regular CPPR jointly with development partners; (c) conducting a comprehensive Country Procurement Assessment Report and implementation review; (d) establishing an implementation task force under Office of National Planning with the stated objective of providing strategic guidance on implementation issues. *Improvement in portfolio performance would support a move from the low-case to the base-case lending scenario.* In addition to the portfolio performance improvement efforts outlined earlier, the Bank is strengthening its quality control efforts through a number of avenues, including Quality Enhancement Reviews of new investment operations with the Quality Assurance Group. Details of the portfolio improvement plan and portfolio performance targets are presented in Attachment 4.

80. **Advisory and Analytical Activities.** The Bank's program in PNG has traditionally included substantial technical assistance and advisory and analytical work. This has allowed the Bank to maintain a dialogue with the Government on socioeconomic issues while pursuing the longer-term objectives of reforms in a number of areas. *The Bank will maintain its focus on advisory and analytical activities to fill the knowledge gap in specific sectors, namely agriculture and rural development, and will undertake this work in cooperation with PNG institutions and with PNG's strategic development partners.* The advisory and analytical work program is outlined in Table 3 (page 27).

Box H: Status of Portfolio (US\$ million)													
Name of the Project	GRA			Effective Date	Disbursements				GRA cumulative Disbursements	Closing Date	Latest Supervision ^b		
	Amount	Emergency Operations	Cancel-lation		In FY97	In FY98	In FY99	Cumulative to FY99a			DO	IP	Projects at Risk
Current Portfolio													
Public Sector Training	20.80	12.50	0.00	7/3/91	5.29	7.52	0.37	19.87	12.50	9/30/99	S	S	Potential
Oro Smallholder Oil Palm	27.00		0.00	8/31/93	1.21	2.31	3.66	11.31		12/31/99	S	S	Potential
Education Development	35.00	5.00	0.00	2/1/94	2.18	3.95	2.06	17.28	5.0	12/31/01	S	U	Actual
Population and Family Planning	6.90		0.00	12/22/93	0.43	0.37	1.45	3.09		12/31/99	S	U	Actual
Petroleum TA	11.00		0.00	9/21/94	3.54	3.30	2.39	10.42		9/30/00	S	S	Nonrisky
Emergency El Niño	5.00		0.00	7/15/98			0.68	0.68		6/30/01	U	U	Actual
Total	105.70		0.00		12.65	17.45	10.61	62.65					

^a As of June 30, 1999.

^b DO: Development Objective Rating; IP: Implementation Progress Rating; S: Satisfactory; U: Unsatisfactory.

81. The Bank will continue basic economic monitoring and analysis work, and deepen its understanding of structural issues through a Public Expenditure Review (FY00) and a Structural Policy Review (FY01). Devolution of responsibilities to provinces was undertaken without sufficient planning and has created major service delivery problems. A review of the decentralization process will be undertaken with the objective of identifying bottlenecks in the decentralization process and developing an action plan for capacity development at the provincial level.

82. **Lending Services.** Operations under the low-case scenario focus on sectors where the Bank has demonstrated effective implementation mechanisms (such as the Second Gazelle Restoration Project and resource-sector technical assistance), or where strategic considerations in terms of global environmental protection (Forestry and Conservation Project) and partnerships (Highlands Highway) are significant and improve the leverage for more effective implementation. The investment operations are being designed in consideration of the difficult implementation environment and answer pressing needs of the people and the global concern about deforestation and biodiversity protection, respectively. *Under the low-case scenario, total assistance would be in the range of US\$50-100 million.*

83. In close cooperation with the IMF, the Bank will continue its dialogue with the authorities to establish and agree on a program to restore macroeconomic stability and improve the transparency of the Government's fiscal and monetary activities. Should common ground on critical policy reforms be found, the Bank would engage more broadly, beginning with a structural reform program that would set the stage for more in-depth sector reforms. The adjustment operation would provide balance of payment support and assist in alleviating some of the macro- and micro-economic distortions which are pervasive in PNG and which impose significant costs in terms of economic efficiency.

84. Comprehensive reforms in the areas of fiscal and monetary management, and sector-specific reforms would lay the groundwork for a more ambitious investment program. The resulting high-case scenario includes a community-based rural development project and an operation in education.

85. *The International Finance Corporation's (IFC) activities to date have focused on providing support to small-scale private sector projects through the South Pacific Project Facility (SPPF) and the Pacific Islands Investment Facility (PIIF).* In February 1997, SPPF established an office in Port Moresby staffed by a professional from PNG's Small Business Development Corporation (abolished in 1999 budget) and funded by a grant from AusAID. SPPF continues to assist in the development of small-scale PNG business ventures while expanding and encouraging the transfer of business analysis and project development skills to Papua New Guinea citizens. During 1998, SPPF received and dealt with 115 new

project inquiries and by year end, eleven of these projects' financing proposals were well advanced and three had received financing offers. *As of March 31st 1999, SPPF had six completed financing proposals lodged with and under consideration by PNG banks.*

86. To execute SPPF's private sector project development strategy in PNG, SPPF will concentrate on developing business opportunities from within sectors where PNG still enjoys a level of sustainable competitive advantage, such as mining, timber and fishing, although recent depreciation of the Kina is creating new opportunities. SPPF received 29 new business inquiries for "mainstream" scaled ventures in 1998. Without a substantial improvement in the business climate in 1999, best estimates are that 1999 will see about 20 new inquiries, of which, subject to affordable financing becoming available, two can be expected to ultimately develop into funded deals.

87. The depressed economic conditions prevailing in PNG during 1998 and 1999 will continue to impact interest in pursuing larger scale business development projects. IFC has been approached by sponsors operating in the oil, gas and mining sectors, but there are no advanced projects presently under preparation. The IFC was recently approached by PNG's Office of Public Enterprise and Asset Management for support the development of a comprehensive privatization program. It has been agreed to provide technical assistance through IFC's Corporate Financial Services Department and help PNG develop the strategic and operational framework for an effective privatization program.

88. As of September 30, 1999, the Multilateral Investment Guarantee Agency (MIGA) had issued two guarantees, for a total maximum aggregate liability of US\$75 million, in the mining sector in Papua New Guinea.

D. COUNTRY PROGRAM MONITORING

89. **Risk Management and Creditworthiness.** With its heavy dependence on natural resources and agricultural production, *the economy of Papua New Guinea remains vulnerable to climatic and terms-of-trade shocks. This will not change significantly in the short to medium term.* Although its natural resource exports include several commodities, simultaneous downturn in all or most of the commodity prices can happen, as is the case now. This situation requires close monitoring of developments in the commodity sector and tight management of hard currency reserves.

90. *PNG is a moderately indebted country with a total external debt to GDP ratio estimated at 58 percent in 1998 and a debt service ratio of around 13 percent.* Over the next several years, however, PNG's debt outlook will depend on the source and terms at which the country secures external funding for the 1999 and subsequent budget years. Official sources of funds would keep debt indicators within manageable levels and PNG would have greater flexibility in determining the extent of its exposure to the higher cost commercial options. Total external debt, which has dropped by about 30% in the last five years, now stands at just over US\$2 billion. This has been achieved mainly through repayment of commercial debt of both public and private origin. Under the base case lending scenario, the debt service ratio would decline steadily to about 9%, reflecting continued repayment of commercial and multilateral debt and limited access to new commercial financing.

Table 3: Indicative Assistance Program, Lending Scenarios and Triggers

Fiscal Year	Lending Services Operation	Analytical Studies, Advisory Services and Capacity Building
Low Case Scenario: Adoption of the low-case scenario is based on the following prevailing conditions: (a) fragile macroeconomic stability with no improvement in the governance environment; (b) poor performance on budget implementation in the social sector ; (c) poor performance of the PNG portfolio and difficulties in mobilizing counterpart funding; (d) continued policy reversals/backsliding of the structural reforms implemented under the 1995 Economic Recovery Program; (e) uncertainty regarding the country's position towards a stronger partnership with the Bank.		
FY00	Second Gazelle Restoration (FY99 carry-over) Forestry and Conservation (FY99 carry-over) (IBRD and GEF) Mineral Sector Institutional Development (LIL)	<ul style="list-style-type: none"> • Country Assistance Strategy (FY99 carry-over) • Report on Poverty (FY99 carry-over) • Rural Development and Agriculture Strategy • Public Expenditure Review • Consultative Group Meeting • Country Procurement Assessment Report • Country Portfolio Performance Review
FY01	Gas Sector Institutional Development	<ul style="list-style-type: none"> • Structural Policy review • Decentralization and Service Delivery • Country Assistance Strategy – Update • Environment Strategy Note • Country Portfolio Performance Review
FY02	Highlands Highway Rehabilitation	<ul style="list-style-type: none"> • Country Economic Memorandum • Consultative Group Meeting • Country Portfolio Performance Review
Total FY00-02: US\$50-100 million		
Base Case Scenario Triggers. The PNG program would move into the base case lending program on the basis of the following characteristics/triggers: (a) substantive reengagement with the Bank and IMF on critical reform issues, including an agreement on the macro framework ; (b) adoption of project and portfolio performance improvement plans with early gains in portfolio improvement ; (c) allocation of necessary resources to priority social sectors; (d) condition of effectiveness of new projects are achieved within agreed timeframe; (e) enhanced efforts to manage PNG's natural resources in a sustainable and transparent manner is expressed in a revision of recent policy decisions.		
FY00	Same as low case	Same as low case
FY01	<ul style="list-style-type: none"> • Structural Adjustment Loan • Rural Road Maintenance and Rehabilitation • Gas Sector Institutional Development 	<ul style="list-style-type: none"> • Structural Policy review • Decentralization and Service Delivery • Country Assistance Strategy – Update • Environment Strategy Note • Country Portfolio Performance Review
FY02	<ul style="list-style-type: none"> • Highlands Highway Rehabilitation • Public Sector Reform/Civil Service Develop. • Financial Sector Reform 	<ul style="list-style-type: none"> • Country Economic Memorandum • Consultative Group Meeting • Country Portfolio Performance Review
Total FY00-02: US\$200-250 million		
High Case Scenario Triggers: In addition to base-case triggers, the following triggers would have to be met to support a move to the high case scenario: (a) Government successfully completes second phase of structural reforms with no significant delays or backsliding; (b) tangible progress in streamlining budgetary mechanisms and resource transfer systems supportive of service delivery; (c) more effective coordination of donor assistance through a CDF-type approach is achieved; iv) portfolio performance targets for FY00 and FY01 are achieved.		
FY00	Same as low case	Same as low case
FY01	Same as base case	Same as base case
FY02	<ul style="list-style-type: none"> • Highlands Highway Rehabilitation • Public Sector Reform/Civil Service Develop. • Financial Sector Reform • Community-Based Rural Development • Education Sector Reform 	<ul style="list-style-type: none"> • Country Economic Memorandum • Consultative Group Meeting • Country Portfolio Performance Review
Total FY00-02: US\$250-300 million		

91. *PNG remains creditworthy for Bank lending.* This assessment is based on its balance of payments prospects, a large share of grants in total official flows on a sustained basis and, at present, a low, manageable debt service ratio. *Papua New Guinea's repayment record to the Bank is good. Overall Bank exposure to PNG is low, representing only 0.3 percent of the Bank's portfolio. However, because of accelerated repayment of commercial debt, PNG currently breaches Bank exposure guidelines relating to: a) preferred creditor to public debt service ratio, and; b) IBRD to public debt service ratio. With a deliberate strategy to reduce private source debt, and substantial bilateral aid inflows, in the form of grants, the preferred creditor share of PNG public debt service reached an estimated 50 percent in 1998 and is projected to rise to around 65 percent by 2002 under the base case. Likewise, the Bank's share in public debt service would reach 36 percent by 2002, up from an average of 18 percent during 1995-7, mainly a result of reduction in commercial debt.*

92. *Most operations in PNG are at risk from the outset.* The unresolved systemic implementation issues will make project implementation difficult at best but the Bank's understanding of the implementation framework continues to improve and the Bank will work with other donors more effectively to resolve implementation issues. The implementation risks should begin to ease in the outer years of the CAS period. Significant portfolio and implementation performance improvement effort has been built into the overall assistance strategy.

93. **CAS Performance Indicators and Bank Benchmarks.** *The uncertainty associated with the level of Bank engagement in PNG makes it difficult to identify CAS-specific performance targets and benchmarks. The Bank's portfolio in PNG is now relatively small compared to overall official development assistance, and the significance of the Bank's contributions to development progress cannot easily be isolated from those of other donors. The CDF framework, once adopted by PNG, will provide a common set of performance indicators for all donors active in PNG. Part of Australia's assistance to PNG will be based on performance indicators jointly agreed with the Bank and IMF. The performance indicators have therefore been developed on the basis of successful implementation of the base-case lending program and sector-specific performance targets that have been developed through sector strategies and endorsed by PNG. A CAS Progress Report will be prepared within 12-18 months and CAS indicators and benchmarks will be revised accordingly. Regular portfolio review exercises will provide a basis upon which to monitor developments regarding how effectively systemic issues affecting project implementation are being addressed.*

E. Risks

94. While the CAS strategy is conservative and inclusive of risk mitigation measures, there are nevertheless a number of risks on the horizon which could undermine CAS objectives, namely:

- Continued weak macroeconomic management and poor economic governance, leading to a further deterioration of the fiscal situation, which in turn would worsen the lack of transparency in the administration of public funds. The fiscal crisis could lead to a financial sector crisis;
- Delays and/or difficulties in meeting targets of a macroeconomic stabilization program, resulting in significant delays in progressing structural policy reforms agreed with the Bank;
- Worsening of systemic issues affecting project implementation, an indication of weak commitment to project implementation, jeopardizing the feasibility of the base-case lending scenario and associated objectives of improved service delivery and rural development;
- Further worsening of the law and order problems, resulting in mitigated private sector investments and difficult field implementation conditions, further undermining CAS objectives.

4. CONCLUDING REMARKS

95. PNG's new government has publicly recognized the severity of the issues now facing the country and indicated its commitment to begin the necessary reforms. In the brief time since taking office, the administration of Prime Minister Morauta has outlined its policy position and strategic direction in a number of areas. Most notably the new government has: a) prepared and passed a supplementary budget which signals a significant change in direction, including the targeting of a fiscal surplus in the second half of the year; b) halted the poorly structured civil service retrenchment program; c) reinstated funding for important research, educational and other public institutions, and; d) initiated a privatization program and set-up a privatization commission, with the intention of further rationalizing the use of government resources. These initial actions signal that the administration is ready to consider and implement difficult but necessary reforms. This is possibly the best window of opportunity for the Bank and other donors to support a comprehensive reform program in PNG.

96. *PNG is at a crossroads, at a point in its development where targeted Bank support could make a significant contribution to economic and social development efforts.* Although modest at first, Bank assistance to PNG will be stepped-up subject to performance on structural reforms and project implementation. The partnership must also be strengthened in order to support a more substantive engagement. Bank assistance is seen as an important element in rebuilding a sense of confidence needed to reestablish macroeconomic stability and economic growth. Finally, through enhanced coordination and more effective strategic planning, on-going and future programs can be made to support improved governance and poverty alleviation more effectively.

James D. Wolfensohn
President

By: Sven Sandström

Washington D.C.
October 21, 1999

ATTACHMENT 1: SOCIAL SERVICES IN CRISES—PRESS COVERAGE OF 24 APRIL 1999

Nurses' cry to Govt: We need protection at city hospital

Nursing staff at Port Moresby General Hospital have given the Government until Friday to consider increasing funding for the hospital. They claim a shortage in funding was affecting staff security and patient care, resulting in substandard services. The demand was among several agreed to at an emergency lunch-hour meeting yesterday, following an attack on a woman doctor and others at the children's clinic on Monday. It was also agreed that the clinic should remain closed, and that police must arrest and charge those responsible. They also resolved that relatives should educate the alleged attackers, that Health Minister Ludger Mond should intervene, especially at the parliamentary level, that police be at the hospital and a police escort to be provided for drop-offs and pick-ups, especially for night shift staff. They said funding cuts in the 1999 Budget had seriously affected the quality of health services being provided and the Government should increase funding by the middle of this year. Health Workers Federation president, Dr. Bob Danaya, said unless the safety of staff was guaranteed, the children's clinic would stay shut. Minister Mond condemned the attack and called on police to arrest those responsible. Police said yesterday no arrests had been made. Mr. Mond said with the continuous financial constraints, work pressures and demands affecting doctors and nurses across the country, such actions were uncalled for. He said there were set procedures for aggrieved people to follow if they had any complaints against any nursing staff. The hospital board would investigate and if the complaints were found to be true, those responsible would be either suspended or dismissed. Mr. Mond said cases can also be referred to the Coroner's Court for investigation. "They may have complaints and some may be genuine but they have to take the right approach," he said. "The way they did it was uncalled for. Children were affected and some may even die." Dr. Danaya said there was no point in cutting down staff when the hospital was providing substandard service. "It is not well in the hospital and the management know this. Lives are being lost unnecessarily because of this (lack of funding)," he said. "We've got to provide the best service we can give to our people. The time for pretending is over." Dr. Danaya said the doctor who was attacked had done all she could with the sick child and the relatives must understand this fact. A post-mortem will be conducted on the child today to establish the exact cause of death.

Enga schools to close over Waigani debt

All the schools and other educational institutions in Enga are expected to close next week. Governor Peter Ipatas will direct the education authorities to shut all the schools because there is no money to pay school subsidies. The province has not received its quarterly allocation from the Treasury Department. Mr. Ipatas told the Post Courier from Wabag yesterday that he might close all the schools and other educational institutions. Mr. Ipatas, who places education as his top priority, has called on Treasurer Iairo Lasaro to immediately release the funds for his province. "We have budgeted K 4 million for education subsidies in our provincial budget for 1999, however the province is not receiving its quarterly allocations from the Treasury Department," he said. "All schools in Enga are going to close next week for this quarter because the National Government has not released the funds we've budgeted for to pay our schools." "I call on Minister Iairo Lasaro to immediately release the funding from my special support grant this week to pay the schools," Mr. Ipatas said. The first quarter school subsidies were paid by the National Government. The second quarter amount is for the provincial government to pay. Mr. Ipatas said in the first half, the Government had only paid one quarter of the full amount to the schools. He said he had made several attempts and also sent letters to the minister and Secretary Brown Bai for the release of the funds. However, there had been no reply. "I put education as my government's number one priority and the monies must be released for the schools to continue as normally as possible," Governor Ipatas said. He said if the Treasury Department released K 2 million to the provincial treasury, all the government's obligations would be met. Mr. Ipatas said the closure of the schools would not be the provincial government's fault. "We've budgeted for it and are ready to pay the schools their subsidies whenever the funds are received from Waigani," he said. Enga is the only province in the country that subsidizes free education for school children within the province and those studying at educational institutions.

Source: PNG Post Courier, 24 April, 1999

SECTOR	TECHNICAL ASSISTANCE AND INVESTMENT PROJECTS	FUNDING AGENCY
Education		
Ongoing (Cont.)	Scholarship Program Tertiary Institution Building Vocational Training School Support In-country Training T.A. Maintenance School Program Long Term Study Awards (tertiary) Long Term Study Awards (secondary) Short Term Mid -Career Training Awards In-Country Training Courses School Journals Phase II Simbu In-Service Training Project Increasing Awareness of Social Issues Non-Formal Education and Adult Literacy Innovative Approaches to Basic Education Research, Monitoring and Evaluation of Education Reform	EU EU EU EU EU New Zealand New Zealand New Zealand New Zealand New Zealand New Zealand UNFPA, UNICEF, WHO, UNDP/GEF, UNESCO, UNHCR UNESCO UNESCO
Pipeline	Skills Development and Employment Adult Education PNG-Australia Targeted Training Project Female Participation in Education Sandaun Provincial High School Primary and Secondary Teacher Education Secondary Schools Equipment Curriculum Development Aitape School Rehabilitation UPNG Equipment Supply Project National Education Media Center Development	ADB ADB Australia Australia Australia Australia Australia Australia EU Japan Japan
Health		
Ongoing	Provincial Towns Water Supply Rural Health Program Hospital Management and Operations Improvement Population and Family Planning Project Sexual Health and HIV/AIDS Prevention and Care Project Women's and Children's Health Project Pigbel Vaccine Supply Project Field Site Support for Malaria Vaccine Trials Project Medical Officer, Nursing and Allied Health Sciences Training Project Tertiary Health Services Project Health Sector Support Program Rural Water Supply Women and Children's Primary Health Care Increase Health Services to Rural Majority Expand Health Promotion and Preventative Health Services Reorganize and restructure the National Health System Develop Health Staff Professional, Technical and Management Skills Upgrade and Maintain Investment in Health Infrastructure	ADB Australia Australia Australia Australia Australia Australia Australia Australia Australia Australia EU New Zealand WHO, UNICEF, UNFPA UNICEF, ILO, WHO WHO, UNFPA WHO, UNFPA, UNICEF WHO, UNFPA, UNICEF
Pipeline	Provincial Towns Water Supply Health Program Review Health Promotion and Protection (2001) Medical Equipment Management Project National Health Service Radio Network Pharmaceutical Upgrade Project Disease Control AIDS Children's Health Port Moresby Sewerage System Goroka Water Supply and Sewerage System Upgrading Provincial Water Supply Project (Vanimo & Lorengau) Investigation and Development of Groundwater Sources for Water Supply	ADB ADB ADB Australia Australia Australia Australia EU Japan Japan Japan Japan Japan
Physical		
Environment		
Ongoing	Ecoforestry Islands Region Community Development Program SGS - Log Monitoring Export Environmental Monitoring & Management of Mining	EU EU EU EU

SECTOR	INVESTMENT PROJECT	FUNDING AGENCY
Environment Ongoing (Cont.) Pipeline	Forest Research Institute Project Phase II NGO Environment and Development Projects NGO Capacity Building NGO Institutional Strengthening Development and Sustainable Management of Natural Resources Implementation of International Environmental Conventions Coastal Environment TA Coastal Environment (2002) Ecoforest Program – PNG	Japan New Zealand New Zealand New Zealand UNDP/GEF UNDP/GEF, UNEP, WMO ADB ADB EU
Transportation Infrastructure Ongoing Pipeline	Ramu Highway Upgrading Medical Faculty of UPNG TA Dept. of Works Wapenamanda to Wabag Highway Upgrading Project Highlands Highway Upgrading Project National Roads Regravelling and Sealing Project Lae City Roads Bridge Replacement and Upgrading Project Maritime College Upgrading Project Aviation Rescue and Fire Fighting Services Project Air Traffic Control Radar Training Project Transport Sector Support Program Airport Maintenance and Upgrading Project Aviation Management Information System Communications sector Support Program Port Moresby International Airport Redevelopment Project Phase II Trans-Island Highway Project National Road Improvement Project Reconstruction of Radio East New Britain, National Broad Casting Reconstruction of Umi Bridge along Highlands Highway Road Upgrading and Maintenance (1999) Road Sector Management and Cost Recovery Highland Highways Management Maritime Administration Road Sector Policy Studies Provincial Ports Maritime Navigation Aids (2000) Highlands Highway (2001) Provincial Ports (2002) South Fly Telecommunication Project Inland Waterways Project Balus Aviation Project Roads and Bridges Rehabilitation	EU EU EU Australia Australia Australia Australia Australia Australia Australia Australia Australia Australia Australia Australia Japan Japan Japan Japan Japan ADB ADB ADB ADB ADB ADB ADB ADB ADB ADB ADB Australia Australia Australia EU

ATTACHMENT 3: THE PARTICIPATORY PROCESS OF THE CAS

Consultations regarding the Country Assistance Strategy (CAS) for PNG entailed a series of day-long meetings with roughly 180 leaders of NGOs (local and international), community-based organizations, churches, professional groups, business groups, private sector representatives, government departments and civil servants from 16 of PNG's 20 provinces. These meetings were held in Port Moresby, Lae (capital of Morobe province) and Mt. Hagen (capital of Western Highlands province). Attendance details are provided in Table A. The Bank team informed participants of the role and rationale for a Country Assistance Strategy and explained how it could benefit from civil society's inputs. A variety of techniques were used to formulate development priorities in the different working groups, including the development of a long-term vision for Papua New Guinea. The nature of the concerns raised during those meetings are summarized in Table B. The priorities identified fall under three main headings: (a) good governance, (b) improved service delivery and (c) better management of natural resources. Although priorities reflected some regional preferences, they were broadly consistent with the themes in the Government's Medium-Term Development Strategy. The strategies identified by the participants and discussed during the consultations are listed in Table C.

The consultative meetings also afforded the Bank team an opportunity to engage in productive dialogue with key service providers, forge closer relationships with the NGO and CBO community, create a viable constituency for sustainable reform and reflect community priorities in its program. The broad-based representation and wide geographical coverage achieved signals a further deepening in the Bank's relations with civil society in PNG.

In addition to providing the Bank a clearer understanding of the issues affecting everyday life in PNG, the consultations provided a vision for PNG's development over the next 15 to 20 years. The cornerstone of the vision for PNG is to enhance village life so that it provides its inhabitants with a caring environment that emphasizes human development that is considerate of people's traditions and the natural environment. Enhanced village life would:

- encourage young villagers to pursue educational, work and life experiences in their native village, thereby reducing migration to urban areas and the associated social and urban decay;
- provide increased opportunities to participate in the cash economy as one element of a broader trade and commerce setting, with particular emphasis on agriculture and sustained use of natural resources;
- provide a constructive setting for social and economic development to occur that is considerate of people's wishes and desires, and;
- provide easy access to basic health and social services that are necessary to sustain a productive and cohesive population.

The Bank team was also able to address generic questions about the Bank's role in PNG, the use of conditionalities in its adjustment operations, the share of national debt owed to the Bank and other issues raised by participants. The general lack of information and misinformation about the Bank, its role and its relationship with the Government, among others, indicate a strong need to maintain an open and transparent dialogue with civil society.

Table A. Attendance Details

	POM I	POM II	Lae	Mt. Hagen	TOTAL	% total
Local NGOs	21	5	25	24	75	42.61
Church Groups	4	1	5	11	21	11.93
International NGOs	1	8	14	1	24	13.64
Multilaterals	0	1	0	0	1	0.57
Professional Organizations	1	6	5	0	12	6.82
Government Departments	3	4	1	18	26	14.77
Business Sector	1	0	0	11	12	6.82
Private	0	1	0	4	5	2.84
Total	31	26	50	69	176	100.00

Table B. Concerns Raised During Meetings

	Port Moresby I	Port Moresby II	Lae	Mt. Hagen
Targeted community development programs	X	X	X	X
Inadequate dialogue between Government and NGOs	X	X	X	X
Inadequate dialogue among NGOs	X		X	
Problems with World Bank conditionality	X		X	X
Perceived high cost of World Bank loans		X		X
Poverty impact of adjustment programs	X	X		
Inadequate community participation in development	X			
Need for more direct funding for NGOs	X	X		
Adverse effects of pervasive corruption	X	X	X	
Difference between the CAS and SAP			X	
Have World Bank loans increased debt?		X		X
Ownership structure of the World Bank				X
Can the Bank help enhance accountability?		X		X
If PNG is resource rich, why borrow?			X	X

Table C. Community Medium-Term Development Priorities and Strategies for PNG

Issue	Priority	Strategy
Governance	Accountable public service and transparent policies	<ul style="list-style-type: none"> • Review wage structure • More incentives and security of tenure for civil servants • Enforce penalties for corruption expeditiously, fairly and effectively • Simplify procedures and improve monitoring
	Improved dialogue with civil society	<ul style="list-style-type: none"> • Establish regular meetings • Involve NGOs more directly in policy dialogue
	Electoral reform	<ul style="list-style-type: none"> • Reintroduce proportional representation system • Eliminate MP's discretionary grants
	Strengthen provincial government	<ul style="list-style-type: none"> • Clarify roles and responsibilities • Facilitate transfer of funds and responsibilities
Service Delivery	Make basic health and education facilities more affordable, accessible and appropriate	<ul style="list-style-type: none"> • Facilitate NGO and church involvement • Basic health and education facilities within half day's walk from any settlement • Adequate staffing and equipment • Facilitate release of funding • Free, compulsory primary education
	Reduce infant and maternal mortality rates	<ul style="list-style-type: none"> • Universal immunization for all under-five • Training of midwives and village birth attendants in every village • Increase education and public awareness campaign
	Contain incidence of AIDS/STD/drug abuse	<ul style="list-style-type: none"> • Increase public awareness campaign • Target vulnerable groups more directly
	Create more awareness of service delivery targets at grassroots levels	<ul style="list-style-type: none"> • Involve NGOs and community leaders in awareness, participation and evaluation campaigns • Institutionalize feedback mechanisms
	Incorporate vocational and traditional education	<ul style="list-style-type: none"> • Revise curriculum • Funding for relevant institutions
Resource Management	Develop more sustainable economic activity	<ul style="list-style-type: none"> • Increased awareness of conservation and biodiversity issues • Effective enforcement of conservation clauses in resource contracts
	Introduce more "downstream" processing	<ul style="list-style-type: none"> • Appropriate training and research to determine comparative advantage • Facilitate indigenous industry
	Improve monitoring of activity in mining, forestry and fisheries departments	<ul style="list-style-type: none"> • Restructure and fully fund relevant departments • Close review of existing activity • Enforcement of existing legislation
	Ensure more equitable distribution of rents	<ul style="list-style-type: none"> • Review contracts • Supervise activity of Land owner Organizations • Minimize smuggling and unfair business practices

ATTACHMENT 4: PNG—PORTFOLIO PROFILE, PERFORMANCE AND IMPLEMENTATION ISSUES

A. Status

The PNG portfolio currently consists of six projects, all IBRD, with a total commitment of US\$105 million, about US\$40 million of which had yet to be disbursed at the beginning of FY00. The full portfolio status and basic performance indicators are presented in Table 1 below. Of the six projects in the portfolio three are currently rated as problem projects while two others are judged to be potential at risk. The present project risk rating is presented in Table 2. After a short period of performance improvement in 1997, the portfolio resumed a downward trend resulting today in five projects that are deemed to be at risk. The commitment at risk represents over 85 percent of the portfolio. Disbursements rates have nevertheless been reasonable, mainly because of the relatively quick disbursing GRA I project (now closed) and on-schedule implementation of the Petroleum Technical Assistance Project. The average age of the portfolio should have led to even higher disbursement rates given that a number of projects are expected to close in the next 12-18 months.

Table 1: End-of-Year Portfolio Status for FY98 and FY99

	FY98 Actual	FY99 Actual
<i>I. Portfolio Status</i>		
Projects under Implementation	6	6
Total Net Commitment (US\$ million)	105.7	84.9
Projects at Risk	4 (67%)	5 (80%)
Commitments at Risk	85%	89.6%
of which Actual Problem Projects	1 17%	3 50%
<i>II. Service Standards</i>		
Portfolio Management Composite Index	95%	83.5%
<i>III. Supervision Efforts</i>		
Project w/o supervision reports update for 6 months	0	0
<i>IV. Other Performance Indicators</i>		
Disbursed Amount (US\$ million)	17.45	9.79
Disbursement Ratio	26.4%	18.2%
Overdue Audit Reports	2	2
Projects with current FY closing Dates	1	1
<i>V. Portfolio Restructuring</i>		
Mid-term Review	0	0
Effectiveness delays	0	0

Three of the six projects are rated as satisfactory on the basis of implementation progress (IP) and development objectives (DO). Two projects have unsatisfactory IP but satisfactory DO. The most recent addition to the portfolio, the El Niño Drought Recovery Project, is experiencing startup difficulties and is presently rated as unsatisfactory on both fronts, although this is expected to change once the startup problems have been resolved.

Table 2: Projects at Risk and Contributing Factors

<i>Project</i>	<i>At Risk Status</i>	<i>Risk factors</i>
Population and Family Planning	Actual	1. Project management problems, 2. Procurement problems, 3. Disbursement delays, 4. Long history of past problems, 5. Risky country. 6. Poor macroeconomic setting
El-Niño Drought Recovery	Actual	1. Project management problems, 2. Disbursement delays, 3. Risky country, 4. Poor macroeconomic setting
Education Development	Actual	1. Project management problems, 2. Procurement problems, 3. Disbursement delays, 4. Long history of past problems, 5. Risky country. 6. Poor macroeconomic setting
Public Sector Training	Potential	1. History of past problems, 2. Risky country, 3. Poor macroeconomic setting
Oro Smallholder Palm Oil	Potential	1. Poor financial performance, 2. Significant disbursement delays, 3. Risky country, 4. Poor macroeconomic setting

B. Project and Portfolio Issues

The last Country Portfolio Performance Review (CPPR) for Papua New Guinea (PNG) was conducted in October 1996, with a follow-up summary review undertaken in October 1997. Both reviews identified systemic and project-specific implementation issues affecting project and portfolio performance. Implementation performance improved somewhat after the 1996 CPPR, but only for a short time. Serious implementation difficulties resurfaced in late 1997 and have affected the PNG portfolio ever since. While attention to portfolio quality and implementation issues at the macro level has been sporadic, efforts at the project-level have intensified over the last two years in an effort to reverse the situation and meet project development objectives. While the portfolio remains very risky, it is not due to a lack of supervision efforts. None of the projects have gone unsupervised for more than six months and the supervision intensity is close to three supervision missions per year per project.

Present portfolio performance indicates that the more intensive supervision effort of the last two years has not been sufficient to improve project implementation performance. As would be expected, supervision efforts focused on resolving project-specific issues. Portfolio review findings reveal that most of the project-specific issues are systemic in nature, which in itself is not a surprise, but that most of the issues are, to some extent, exogenous to the projects. This would support the view that adjustments at the project implementation "framework" level may have supported a more systematic resolution of project-specific issues.

The core implementation issues have not changed significantly since the 1996 CPPR. These include but are not limited to:

- *the ongoing (and growing) difficulties in project financial management*, namely accounting functions and annual auditing requirements;
- *the often challenging and sometime confusing activities related to procurement*;
- *the role, responsibilities and accountability of Project Implementation Units (PIUs) within the public service* and role of ONP in project implementation;
- *the importance of leadership* and the creation of a sense of urgency in project implementation;
- *inadequate allocation, and untimely release of counterpart funds*;
- *issues of project and personnel management*, including delays in the appointment of key project managers, staff, and consultant, issues of interagency coordination, and in some cases, issues of law and order that impede efficient project implementation; and
- *disbursement issues*, including late submissions of withdrawal applications and other issues involving the use of "special accounts."

The most recent supervision reports and aide-memoires continue to identify a long list of follow-up items and project deficiencies. The main issues which can be distilled from the long list are consistent with the 1999 mid-year review findings and the 1996 CPPR results. For this purpose, implementation issues were classified on the basis of quality at entry, exogenous factors and endogenous factors. The implementation issues identified above have been categorized along these lines and have been summarized in Table 4 (next page). For each generic issue, the implementation aspect(s) and performance impact(s) were determined on the basis of most recent supervision reports and aide-memoires.

Quality at entry issues also appears to figure prominently among the list of systemic issues. Few if any of the projects met their initial two-year disbursement target, a common indicator of implementation readiness for investment operations. Procurement plans and procurement handbooks do not appear to be standard issue for PNG projects, resulting in significant startup difficulties. The absence of local Bank support for procurement and disbursement activities is probably a contributing factor to the protracted project startup period, but the pervasiveness of procurement issues throughout the lifetime of projects indicates that the issues are more serious. A quick overview of implementation performance reveals an extended list of issues for consideration. Clearly, the portfolio improvement agenda could be quite comprehensive, involving short, medium and long-term actions targeting both direct and indirect elements affecting implementation performance.

C. Portfolio Improvement Action Plan

Improving the quality of the portfolio is a top operational priority for this CAS period and a number of actions have been initiated to address the situation, including:

- Reinstatement of annual Country Portfolio Performance Review (CPPR) as the basis for ongoing focus on operational issues and portfolio improvement efforts. The next full-fledged CPPR will take place the week of October 18, 1999;
- Adoption of a portfolio improvement plan by PNG and close monitoring of its implementation;
- Initiation of a Country Procurement Assessment Report in support of streamlining efforts in the procurement area;
- Quality Enhancement Reviews for all new investment operations in PNG;
- Restructuring of operations with significant disbursement lags;
- Continued intensive supervision of problem projects with special focus on core project management activities (financial management, procurement, statement of expenditure management).

The ultimate objective is to improve overall portfolio quality up to the regional average or better. With the exception of the number of projects, Table 3 outlines the portfolio performance targets under the low-case and base-case lending scenarios. The latter is itself contingent, among other things, on improved portfolio performance. The number of projects at risk will remain proportionally high in PNG given the country-related risk factors.

Table 3: Portfolio Performance

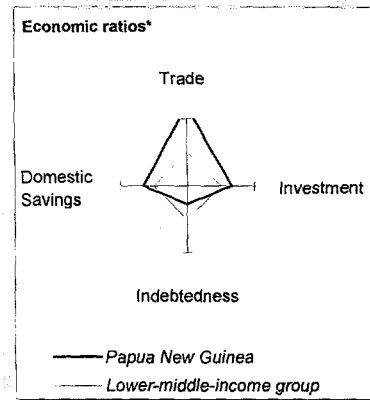
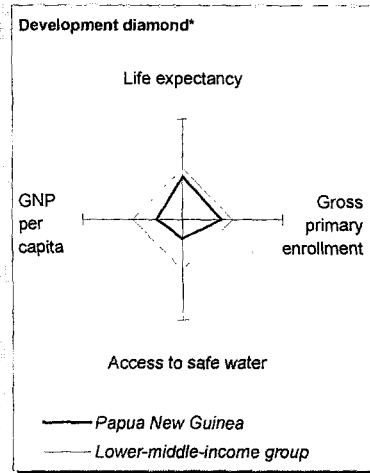
Indicator	FY99 (Actuals)	FY00 (Target)	FY01 (Tentative)
Number of projects under implementation	6	7	9
Number of problem projects	3	2	1
Number of projects at risk	5	3	3
Disbursement ratio (%)	18.2	20	20
CPPR during the year (yes/no)	No	Yes	Yes

Table 4 – Systemic Implementation Issues and Project-Specific Impacts

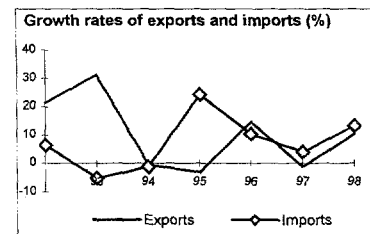
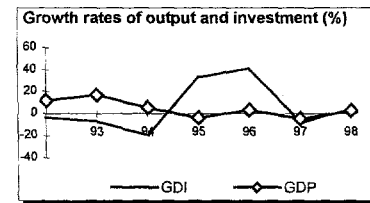
	Generic issue	Implementation angle	Ways in which it impacts performance
Quality at Entry	PIU Staffing arrangements	Difficult to find qualified staff for PIUs No sustainable capacity development on which to build new projects PIU staff often come from public sector PIUs often have difficulty translating projects objectives into manageable work programs	Slow startup of project implementation Each new project starts from a zero-base capacity Pool of qualified candidates often quite limited resulting in long hiring procedure when must go outside public sector
	Complex project structures and multiple objectives	Co-financed projects can present special challenges given the differences in operational requirements and practices of the cofinanciers	Each donor may be pursuing slightly different objectives and utilizing different procurement, reporting and accounting standards. This often leads to confusion, delays, uneven progress in implementation and tension among donors and PIU
	Financial management practices	Confusion regarding special account management	Slow or irregular disbursement
	Quality of Project Implementation Plans	Older projects do not appear to have comprehensive PIPs that can be updated and referred to as the principal work program document	There is often confusion regarding project components, priorities, and general flow of work. This leads to long gaps in implementation as PIUs often revert to sequential processing in lieu of parallel implementation.
	Quality/availability of procurement plans and/ or procurement handbooks	While the Bank procurement guidelines are simple, they are not always made operational at the project level with basic examples of RFPs, procurement evaluation sheets. The first procurement transactions are typically very difficult for the PIUs	Initial procurement of goods and services is often delayed for months until the PIU has gained some procurement experience
Exogenous Factors	Availability and release of counterpart funding	Cash flow management is almost impossible under present resource planning and allocation system	Implementation delays due to delayed procurement for lack of committable funds Poor disbursement record of counterpart funding because of lag between resource availability and disbursement
	Availability and quality of project accountants/ financial managers	The financial management function is generally a weak point across most projects and project accounts are often in poor condition	Confusion over account status quickly leads to disbursement delays
	Public sector hiring/firing policies not considerate of donor-financed project	Hiring freezes or hiring policies affect project unit ability to hire and fire in accordance with business needs and performance	Hiring of staff to replace vacant position (due to transfers or departures) or non-performers is extremely difficult and time consuming with negative impacts on implementation performance
	Public sector procurement boards are generally ineffective	Large procurement contracts typically have to go through a highly politicized Central Supply and Tenders Board and therefore subjected to the great uncertainty regarding consideration and clearance	Procurement contracts are delayed, leading to delayed disbursements and overall slowdown of implementation
	Effects of fiscal belt-tightening	Public or para-public entities with project responsibilities often have their budget slashed or are altogether abolished with little consideration for downstream impacts	Capacities and motivation of entities affects their capacity and willingness to continue supporting project implementation
	Effects of decentralization	More responsibility is being devolved to the provinces, making project implementation arrangements more complex and requiring more coordination	Capacity issues are even more acute in the provinces. Startup and supervision are more challenging. Financial management is also complicated given Special Account rules and cash flow management difficulties.
	Endogenous Factors	Procurement and financial management issues	Capacity to manage basic procurement functions varies greatly from PIU to PIU. There is no cross-support among PIUs nor is there any local support available to advise with the procurement functions.	Implementation and disbursements are delayed, leading to poor performance rating.
Capacity and performance of project managers		Capacity of many PIU managers to carry out project management responsibilities in accordance with project implementation plans and Bank expectations is limited.	PIU motivation suffers, performance drops, tension builds up.
Local follow-up and accountability structures		The role and authority of ONP regarding PIUs and other Departments is either weak, unclear or both	ONP is often unable to exert necessary pressures
Organization of PIUs and implementation units		Full integration of PIUs in public sector limits flexibility in staffing and remedial measures	Project delays due to the inability or reluctance to fire under-performing staff

ANNEX A2: PAPUA NEW GUINEA AT A GLANCE

	Papua New Guinea	East Asia & Pacific	Lower- middle- income		
POVERTY and SOCIAL					
1998					
Population, mid-year (millions)	4.6	1,817	908		
GNP per capita (Atlas method, US\$)	890	990	1,710		
GNP (Atlas method, US\$ billions)	4.1	1,802	1,557		
Average annual growth, 1992-98					
Population (%)	2.3	1.2	1.1		
Labor force (%)	2.3	1.6	1.5		
Most recent estimate (latest year available, 1992-98)					
Poverty (% of population below national poverty line)	..	..	..
Urban population (% of total population)	17	35	58		
Life expectancy at birth (years)	57	69	68		
Infant mortality (per 1,000 live births)	64	37	38		
Child malnutrition (% of children under 5)	30	20	..		
Access to safe water (% of population)	28	77	75		
Illiteracy (% of population age 15+)	28	15	14		
Gross primary enrollment (% of school-age population)	80	117	103		
Male	87	119	105		
Female	74	118	100		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1977	1987	1997	1998	
GDP (US\$ billions)	1.6	3.1	4.8	3.7	
Gross domestic investment/GDP	21.6	20.5	27.1	30.3	
Exports of goods and services/GDP	45.0	43.2	53.6	68.2	
Gross domestic savings/GDP	20.3	14.0	23.0	28.3	
Gross national savings/GDP	28.7	6.1	16.0	21.5	
Current account balance/GDP	6.0	-13.9	-4.7	-1.6	
Interest payments/GDP	2.0	4.9	1.7	1.9	
Total debt/GDP	41.2	72.4	47.7	57.7	
Total debt service/exports	14.8	24.8	14.3	13.3	
Present value of debt/GDP	
Present value of debt/exports	
	1977-87	1988-98	1997	1998	1999-03
<i>(average annual growth)</i>					
GDP	1.6	4.6	-4.6	2.5	1.4
GNP per capita	-0.8	2.0	-7.6	0.1	-1.1
Exports of goods and services	3.6	9.1	-1.2	10.4	2.8



	1977	1987	1997	1998
STRUCTURE of the ECONOMY				
<i>(% of GDP)</i>				
Agriculture	33.0	29.9	27.4	24.4
Industry	26.1	31.7	36.6	42.3
Manufacturing	7.7	9.4	9.5	9.0
Services	40.9	38.5	36.0	33.3
Private consumption	53.7	63.6	54.7	51.0
General government consumption	26.0	22.4	22.3	20.7
Imports of goods and services	46.3	49.7	57.6	70.2
	1977-87	1988-98	1997	1998
<i>(average annual growth)</i>				
Agriculture	2.2	2.8	-4.2	-6.4
Industry	3.2	8.4	-14.2	18.9
Manufacturing	0.7	3.8	5.2	-0.1
Services	2.0	2.8	6.0	-5.5
Private consumption	1.6	2.6	-3.6	9.4
General government consumption	-1.5	0.8	8.4	-13.6
Gross domestic investment	0.1	3.7	-7.8	4.1
Imports of goods and services	1.0	4.8	3.9	13.4
Gross national product	1.4	4.3	-5.5	2.3



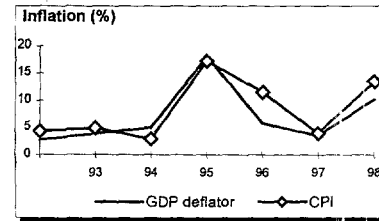
Note: 1998 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Papua New Guinea

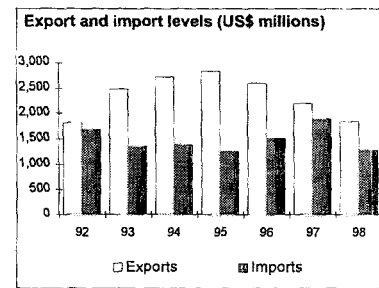
PRICES and GOVERNMENT FINANCE

	1977	1987	1997	1998
Domestic prices				
(% change)				
Consumer prices	4.5	3.4	4.0	13.6
Implicit GDP deflator	7.4	8.0	3.4	10.3
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	29.4	27.7	24.2
Current budget balance	..	3.1	1.0	-0.9
Overall surplus/deficit	..	-7.5	-4.4	-7.4



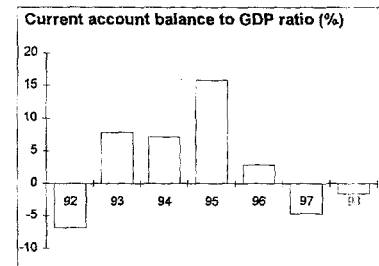
TRADE

	1977	1987	1997	1998
(US\$ millions)				
Total exports (fob)	..	1,259	2,192	1,843
a Gold	..	466	501	607
Copper	..	310	226	323
Manufactures
Total imports (cif)	..	1,292	1,895	1,289
Food	..	203	244	166
Fuel and energy	..	145	208	142
Capital goods	..	390	763	519
Export price index (1995=100)	..	64	100	79
Import price index (1995=100)	103	99
Terms of trade (1995=100)	97	80



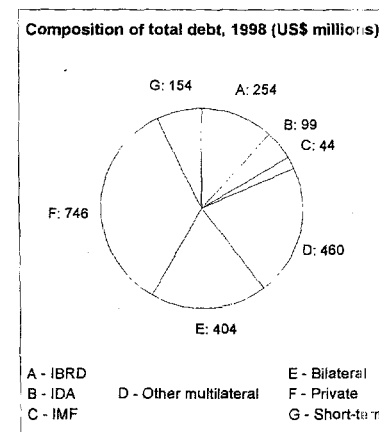
BALANCE of PAYMENTS

	1977	1987	1997	1998
(US\$ millions)				
Exports of goods and services	721	1,306	2,507	2,141
Imports of goods and services	743	1,462	2,396	1,956
Resource balance	-22	-157	111	185
Net income	-51	-177	-303	-237
Net current transfers	172	-105	-32	-6
Current account balance	99	-438	-224	-58
Financing items (net)	39	420	138	-103
Changes in net reserves	-138	18	86	161
Memo:				
Reserves including gold (US\$ millions)	427	437	355	194
Conversion rate (DEC, local/US\$)	0.8	0.9	1.4	2.1



EXTERNAL DEBT and RESOURCE FLOWS

	1977	1987	1997	1998
(US\$ millions)				
Total debt outstanding and disbursed	676	2,276	2,273	2,161
IBRD	51	148	270	254
IDA	31	117	101	99
Total debt service	111	356	374	300
IBRD	5	19	47	49
IDA	0	1	3	3
Composition of net resource flows				
Official grants	243	271	218	232
Official creditors	17	109	-3	2
Private creditors	22	7	-57	-109
Foreign direct investment	..	..	..	..
Portfolio equity	0	0	..	..
World Bank program				
Commitments	19	74	0	5
Disbursements	12	33	48	15
Principal repayments	1	10	31	32
Net flows	10	23	18	-17
Interest payments	3	11	19	20
Net transfers	7	12	-2	-37



ANNEX B2: PAPUA NEW GUINEA—SELECTED INDICATORS OF BANK PORTFOLIO PERFORMANCE AND MANAGEMENT

Indicator	1996	1997	1998	1999
<i>Portfolio Assessment</i>				
Number of Projects under implementation ^a	9	8	6	6
Average implementation period (years) ^b	4.31	5.04	4.85	5.85
Percent of problem projects ^{a, c}				
by number	77.78	37.50	16.67	50.00
by amount	86.22	23.20	33.11	44.37
Percent of projects at risk ^{a, d}				
by number	100.00	80.00	66.67	83.33
by amount	100.00	89.08	84.86	89.60
Disbursement ratio (%) ^e	13.19	19.17	26.40	18.24
<i>Portfolio Management</i>				
CPPR during the year (yes/no)	Yes	No ^f	No	No ^f
Supervision resources (total US\$)	605.16	783.93	366.69	294.44
Average Supervision (US\$/project)	67.24	97.99	61.11	49.07

Memorandum item	Since FY80	Last five FYs
Projects evaluated by OED		
by number	27	10
by amount (US\$ millions)	572.00	309.10
Percent rated U or HU		
by number	48.15	70.00
by amount	51.49	64.57

- As shown in the Annual Report on Portfolio Performance (except for current FY)
- Average age of projects in the Bank's country portfolio.
- Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
- As defined under the Portfolio Improvement Program.
- Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: investment projects only.
- Portfolio reviews and/or mid-year portfolio assessments were carried out

ANNEX B3: BANK GROUP PROGRAM SUMMARY

(a) Base-Case Lending Program, FY 2000-2002^a

FY	Project	US\$M	Strategic	Implementation Risk
			Rewards ^b (H/M/L)	(H/M/L)
2000	Second Gazelle Restoration II (FY99 Carryover)	25.0	M	M
	Forestry and Conservation (IBRD and GEF) ^c	35.0	H	H
	Mineral Sector Institutional Development (LIL)	5.0	M	M
	Subtotal	65.0		
2001	Structural Adjustment Loan	75.0	H	H
	Rural Road Maintenance and Rehabilitation	30.0	H	H
	Gas Sector Institutional Development (LIL)	5.0	M	M
	Subtotal	110.0		
2002	Highlands Highway Rehabilitation	30.0	H	H
	Public Sector Reform	15.0	H	H
	Financial Sector Reform	25.0	H	M
	Subtotal	70.0		
Total, FY 2000-2002		245.0		

a. This table presents the program for the next three fiscal years.

b. For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M), or low (L).

c. Includes a GEF component of US\$17 million

(b) IFC and MIGA Program

Category	Past			
	1996	1997	1998	1999
IFC approvals (US\$ million)	0.00	0.00	0.00	0.00
Sector (%)				
	0.00	0.00	0.00	0.00
TOTAL	100.00	100.00	100.00	100.00
Investment instrument (%)				
Loans	0.00	0.00	0.00	0.00
Equity	0.00	0.00	0.00	0.00
Quasi-Equity	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
TOTAL	100.00	100.00	100.00	100.00
MIGA guarantees (US\$ million)	76.60	76.60	74.92	0.00
MIGA commitments (US\$ million)	0.00	0.00	0.00	0.00

ANNEX B4: PAPUA NEW GUINEA: SUMMARY OF ANALYTICAL AND ADVISORY ACTIVITIES

Product	Completion FY	Audience (1)	Objective (1)	Direct Cost Bank Budget / TF (US\$'000) (2)
Recent Completions				
Gender Study	FY98	G, D, B, P	KG	30.0
Education Sector Review	FY98	G, D, B, P	KG, PS	100.0
Note on Forestry and Gender	FY99	G, D, B, P	KG, PD	25.0
Ongoing				
Note on Community Development Good Practice	FY00	G, D, B, P	KG, PD	20.0
Report on Poverty in PNG	FY00	G, D, B, P	KG, PD	423.0
Country Economic Memorandum	FY00	G, D, B, P	KG, PS	250.0
IDF for Anticorruption Commission	FY00	G, D, B, P	KG, PD, PS	10.0
Country Procurement Assessment Report	FY00	G, D, B	PS	72.6
Public Expenditure Review	FY00	G, D, B	KG	225.0
Country Portfolio Performance Review	FY00	G, D, B	KG, PS	30.0
Consultative Group for PNG	FY00	G, D, B	KG, PS	50.0
IDF for Trade Reform	FY01	G, D, B, P	KG, PD	20.0
Rural Development and Agriculture Strategy	FY01	G, D, B, P	KG, PD, PS	200.0
Planned				
Decentralization and Service Delivery	FY01	G, D, B, P	KG, PD, PS	100.0
Structural Policy Review	FY01	G, D, B, P	KG, PD, PS	200.0
Country Assistance Strategy - Update	FY01	G, D, B, P	KG, PD, PS	50.0
Environment Strategy Note	FY01	G, D, B, P	KG, PD, PS	75.0
Country Economic Memorandum	FY02	G, D, B, P	KG, PD, PS	100.0
Country Portfolio Performance Review	FY02	G, D, B	KG, PS	30.0
Consultative Group for PNG	FY02	G, D, B, P	KG, PD, PS	50.0

Notes: (1) Government (G), donor (D), Bank (B), public dissemination (P), knowledge generation (KG), public debate (PD), problem-solving (PS).

(2) Figures are actuals for the completed activities; actuals plus estimates for the ongoing activities, and estimates for the planned activities.

ANNEX B5: PAPUA NEW GUINEA: SOCIAL INDICATORS

	Latest single year			Same region/income group	
	1970-75	1980-85	1992-97	East Asia & Pacific	Lower-middle-income
POPULATION					
Total population, mid-year (millions)	2.7	3.4	4.5	1,751.2	2,282.9
Growth rate (% annual average)	2.4	2.2	1.9	1.0	0.9
Urban population (% of population)	11.9	14.0	16.6	33.0	42.4
Total fertility rate (births per woman)	6.1	5.8	4.3	2.1	2.2
POVERTY					
<i>(% of population)</i>					
National headcount index	..	..	..	..	..
Urban headcount index	..	..	..	..	..
Rural headcount index	..	..	..	..	..
INCOME					
GNP per capita (US\$)	570	720	930	970	1,230
Consumer price index (1995=100)	28	55	116	114	116
Food price index (1995=100)	..	59	114	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	50.9	..	..
Lowest quintile (% of income or consumption)	..	..	4.5	..	..
Highest quintile (% of income or consumption)	..	..	56.5	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	2.8	1.7	2.6
Education (% of GNP)	4.5	..	..	2.7	5.1
Social security and welfare (% of GDP)	..	..	..	..	..
Net primary school enrollment rate /a					
<i>(% of age group)</i>					
Total	..	..	..	101	99
Male	..	..	..	101	..
Female	..	..	..	102	..
Access to safe water					
<i>(% of population)</i>					
Total	20	..	31	77	78
Urban	30	..	97	..	..
Rural	19	..	18	..	..
Immunization rate					
<i>(% under 12 months)</i>					
Measles	..	54	40	93	93
DPT	..	43	45	93	93
Child malnutrition (% under 5 years)	..	35	30	20	17
Life expectancy at birth					
<i>(years)</i>					
Total	48	52	58	69	69
Male	48	51	57	67	67
Female	48	53	59	70	71
Mortality					
Infant (per thousand live births)	92	69	64	37	36
Under 5 (per thousand live births)	122	92	82	47	44
Adult (15-59)					
Male (per 1,000 population)	496	514	348	183	200
Female (per 1,000 population)	483	478	333	148	142
Maternal (per 100,000 live births)	..	900	370	..	..

a. Ratios exceeding 100 indicate discrepancies between the estimates of school-age population and reported enrollment data.
1999 World Development Indicators CD-ROM, World Bank

ANNEX B6: PAPUA NEW GUINEA: KEY ECONOMIC INDICATORS

Indicator	Actual			Estimate			Projected		
	1994	1995	1996	1997	1998	1999	2000	2001	2002
National accounts (as % GDP at current market prices)									
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture ^a	27.9	26.8	26.5	27.4	24.4	21.4	20.1	21.2	20.5
Industry ^a	37.9	40.7	40.9	36.6	42.3	14.7	13.3	12.6	12.1
Services ^a	34.3	32.5	32.6	36.0	33.3	63.9	66.6	66.2	67.4
Total Consumption	67.2	71.1	67.9	77.0	71.7	62.9	62.2	68.1	65.5
Gross domestic fixed investment	14.5	19.4	27.9	27.1	30.3	35.7	32.4	27.1	30.5
Government investment	2.8	3.6	3.7	5.4	6.9	6.7	6.7	6.6	7.1
Private investment	12.4	15.7	24.2	21.6	23.3	29.0	25.7	20.5	23.5
(includes increase in stocks)									
Exports (GNFS) ^b	53.1	56.4	56.9	53.6	68.2	65.9	74.1	75.7	76.9
Imports (GNFS)	35.4	46.8	52.6	57.6	70.2	64.6	68.7	70.9	73.0
Gross domestic savings	32.8	28.9	32.1	23.0	28.3	37.1	37.8	31.9	34.5
Gross national savings ^c	22.6	21.8	22.5	16.0	21.5	33.3	30.8	24.8	27.5
<i>Memorandum items</i>									
Gross domestic product (US\$ million at current prices)	5542	4853	5318	4760	3746	3568	3370	3512	3629
Gross national product per capita (US\$, Atlas method)	1230	1210	1150	940	890	800	700	670	660
Real annual growth rates (%, calculated from 1983 prices)									
Gross domestic product at market prices	5.2%	-3.6%	3.5%	-4.6%	2.5%	0.8%	1.2%	1.3%	1.4%
Gross Domestic Income	14.0%	-2.2%	-4.1%	-9.5%	5.3%	5.6%	6.4%	1.6%	2.0%
Real annual per capita growth rates (% calculated from 1983 prices)									
Gross domestic product at market prices	2.8%	-5.9%	1.2%	-6.7%	0.3%	-1.6%	-1.3%	-1.2%	-1.1%
Total consumption	10.4%	-0.9%	-11.4%	-2.7%	0.7%	-6.6%	5.1%	3.9%	-2.5%
Private consumption	13.4%	11.2%	-21.3%	-5.8%	7.0%	-3.0%	2.8%	5.4%	-2.9%
Balance of Payments (US\$m)									
Exports (GNFS) ^b	2884	3102	2957	2507	2141	2353	2496	2659	2792
Merchandise FOB	2708	2832	2602	2192	1843	1900	2023	2161	2269
Imports (GNFS) ^b	1942	2005	2278	2396	1956	2304	2316	2490	2649
Merchandise FOB	1314	1268	1520	1484	1109	1239	1197	1306	1402
Resource balance	942	1097	679	111	185	49	180	169	143
Net current transfers (including official current transfers)	-150	-108	-53	-32	-6	127	8	0	0

Continued

Indicator	Actual			Estimate			Projected		
	1994	1995	1996	1997	1998	1999	2000	2001	2002
Current account balance (after official capital grants)	603	967	279	-6	174	46	21	-6	-34
Net private foreign direct investment	71	475	410	-157	15	16	70	80	80
Long-term loans (net)	-649	-240	-200	203	-192	-201	112	4	-67
Official	-19	41	12	-3	2	7	43	24	-12
Private	-630	-281	-212	206	-194	-208	69	-19	-55
Other capital (net, including errors and omissions)	-118	-1010	-145	-126	-157	-28	-140	-62	34
Change in reserves ^d	93	-192	-344	86	161	168	-63	-16	-13
<i>Memorandum items</i>									
Resource balance (% of GDP at current market prices)	17.0%	22.6%	12.8%	2.3%	4.9%	1.4%	5.4%	4.8%	3.9%
Real annual growth rates (1983 Prices)									
Merchandise exports (FOB)	0.2%	-7.9%	-5.6%	-18.2%	4.9%	6.0%	1.6%	2.6%	2.7%
Primary	-1.1%	-1.6%	-20.3%	-16.0%	35.3%	13.1%	3.9%	3.9%	3.5%
Manufactures	..	..	..	..	..	..	..	..	..
Merchandise imports (CIF)	10.9%	-11.4%	24.7%	32.5%	-28.1%	4.5%	5.5%	4.1%	5.6%
Public finance (as % of GDP at current market prices) ^e									
Current revenues	23.2	23.5	25.0	27.7	24.2	21.7	21.5	21.7	21.9
Current expenditures	26.8	24.2	23.3	26.7	25.0	21.5	20.0	19.3	18.9
Current account surplus (+) or deficit (-)	-3.6	-0.6	1.7	1.0	-0.9	0.2	1.6	2.4	3.0
Capital expenditure	2.2	3.7	3.7	5.5	6.5	6.7	6.8	6.6	7.1
Foreign financing	0.9	3.1	2.6	3.5	4.2	3.8	3.4	2.4	0.6
Monetary indicators									
M2/GDP (at current market prices)	30.0	29.2	35.2	38.1	34.3	33.0	32.0	31.7	31.2
Growth of M2 (%)	2.4	10.7	32.0	6.9	1.8	14.4	10.2	8.1	6.0
Private sector credit growth / total credit growth (%)	39.9	-32.6	-57.8	66.1	96.6	116.3	95.0	95.0	95.0
Price indices (1983 =100)									
Merchandise export price index	138	156	152	157	126	122	128	133	136
Merchandise import price index	145	149	144	135	128	118	108	113	115
Merchandise terms of trade index	95	105	106	116	98	104	119	118	119
Real exchange rate (US\$/LCU) ^f	87	100	108	108	91	41	43	42	42
Real interest rates									
Consumer price index (% growth rate)	2.9%	17.3%	11.6%	4.0%	13.6%	31.0%	-7.8%	3.6%	4.2%
GDP deflator (% growth rate)	5.0%	18.1%	5.9%	3.4%	10.3%	18.0%	12.0%	8.0%	6.0%

a. If GDP components are estimated at factor cost, a footnote indicating this fact should be added.

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Should indicate the level of the government to which the data refer.

f. "LCU" denotes "local currency units." An increase in US\$/LCU denotes appreciation.

ANNEX B7: PAPUA NEW GUINEA: KEY EXPOSURE INDICATORS

Indicator	Actual			Estimate			Projected		
	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total debt outstanding and disbursed (TDO) (US\$m) ^a	2792	2513	2359	2273	2160	2067	2002	1930	1882
Net disbursements (US\$m) ^a	-417	-283	-27	60	-108	-92	-65	-75	-46
Total debt service (TDS) (US\$m) ^a	897	626	376	374	300	283	266	250	251
Debt and debt service indicators (%)									
TDO/XGS ^b	93.0	78.6	77.7	86.8	95.7	85.9	78.5	71.1	66.1
TDO/GDP	50.4	51.8	44.4	47.7	57.7	57.9	59.4	54.9	51.8
TDS/XGS	29.9	19.6	12.4	14.3	13.3	11.8	10.4	9.2	8.8
Concessional/TDO	28.5	31.8	33.8	33.0	36.8	39.7	41.4	42.5	41.8
IBRD exposure indicators (%)									
IBRD DS/public DS	12.3	16.1	20.5	17.7	26.6	29.1	29.8	33.7	36.0
Preferred creditor DS/public DS (%) ^c	37.9	35.5	36.9	31.7	50.0	65.1	65.9	62.1	65.2
IBRD DS/XGS	1.5	1.5	1.7	1.8	2.2	2.1	1.9	1.9	1.8
IBRD TDO (US\$m) ^d	281	299	270	270	254	239	277	322	355
Of which present value of guarantees (US\$m)									
Share of IBRD portfolio (%)	..	..	..	..	..	..	..	..	..
IDA TDO (US\$m) ^d	109	108	105	101	99	96	94	91	88
IFC (US\$m)									
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and quasi-equity /c	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
MIGA									
MIGA guarantees (US\$m)	0	0	77	77	75	0	0	0	0

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

ANNEX B8: STATUS OF BANK GROUP OPERATIONS IN PAPUA NEW GUINEA

Operations Portfolio

A. IBRD Loans in the Operations Portfolio in Papua New Guinea as of May 10, 1999

Project ID	Fiscal Year	Borrower	Purpose	Original Amount in US\$ Millions				Difference Between expected and actual disbursements a/		Last PSR Supervision Rating b/	
				IBRD	IDA	Cancel.	Undisb.	Orig	Frm Rev'd	Dev Obj	Imp Prog
Number of Closed Projects: 33											
<u>Active Projects</u>											
PG-PE-4387	1991	Govt. of Papua New Guinea	Public Sector Training	20.80	0.00	0.00	.93	.91	0.00	S	S
PG-PE-4389	1992	Govt. of Papua New Guinea	Oro Smlhldr Oil Palm	27.00	0.00	0.00	15.69	15.30	0.00	S	S
PG-PE-4399	1993	Govt. of Papua New Guinea	Population Project	6.90	0.00	0.00	3.81	3.81	0.00	S	U
PG-PE-4392	1993	Govt. of Papua New Guinea	Education Development	35.00	0.00	0.00	17.72	17.69	0.00	S	U
PG-PE-4391	1994	Govt. of Papua New Guinea	Petroleum Devt TA	11.00	0.00	0.00	0.58	0.29	0.00	S	S
PG-PE-55446	1998	Govt. of Papua New Guinea	Emergency El Niño	5.00	0.00	0.00	4.32	1.42	0.00	U	U
Total				105.70	0.00	0.00	43.05	39.92	0.00		
				<u>Active Projects</u>	<u>Closed Projects</u>		<u>Total</u>				
Total Disbursed (IBRD and IDA):				62.66	569.76		632.42				
of which has been repaid:				9.35	282.71		292.06				
Total now held by IBRD and IDA:				96.35	291.69		388.04				
Amount sold:				0.00	15.39		15.39				
Of which repaid:				0.00	15.39		15.39				
Total Undisbursed:				44.05	0.00		43.05				

- a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.
- b. Following the FY94 Annual Review of Portfolio performance (ARPP), a letter based system was introduced (HS = highly Satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory): see Improvements in Project and Portfolio Performance Rating Methodology (SecM94-901), August 23, 1994.

B. Statement of IFC's Committed and Disbursed Portfolio as of March 31, 1999 (In US\$ Million)

FY Approval	Company	Committed				Disbursed			
		IFC				IFC			
		Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1995	PIIF Masurina	0.19	0.00	0.00	0.00	0.19	0.00	0.00	0.00
	Total Portfolio:	0.19	0.00	0.00	0.00	0.19	0.00	0.00	0.00
		Approvals Pending Commitment							
		Loan	Equity	Quasi	Partic				
Total Pending Commitment:		0.00	0.00	0.00	0.00				

ANNEX B9: CAS PROGRAM MATRIX (FY00-02)

CAS Diagnostic and Program Matrix (FY00-02) and Output Indicators

Program Goal: The overarching goal of the PNG CAS is to support a concerted effort to reduce poverty and improve the quality of life of Papua New Guineans.

Program Objective: The primary objective for this CAS period is to assist PNG in strengthening the foundation for a capable state that can be responsive to its people and begin addressing human and economic development challenges as part of its nation-building efforts.

Program Operational Strategy: The program goal and objectives will be pursued through the implementation of the following two operational strategies: (i) improving the overall governance in support of sustainable development by strengthening fiscal and monetary management systems and institutions, properly funding institutions entrusted with overseeing the proper functioning of government and fighting corruption and, (ii) focusing development assistance to better support rural development through improved delivery of basic services to the poorest and most vulnerable, maintaining and building appropriate infrastructure and building capacity in critical areas of human and resource management.

Key Issues and/or Objectives	DIAGNOSIS	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
<p>A.1 – <u>Establish accountability and transparency in core Government operations in order to: i) enhance accountability in the use of public funds; ii) improve the effectiveness of the public sector; iii) reduce the opportunities for mismanagement or corrupt practices; iv) restore some sense of confidence in public policies and administration</u></p>	<p>There continues to be regular off-budget and unbudgeted expenditures, some of which are quite significant, which undermine fiscal discipline and perpetuate a sense that public funds have a significant discretionary nature and are available to office holders for the strengthening of their position and power.</p> <p>The Ombudsman, Attorney General and the Auditor General's office have not been fully effective due to shortage of operational funding. Furthermore, their findings and recommendations have not been fully enforced.</p>	<p>All expenditures and quasi-fiscal operations must be subjected to the rigors of the full budget scrutiny and rigors of proper fiscal management, including activities relating to state-owned financial institutions and public sector enterprises.</p> <p>Reestablish the integrity of the budgetary process through the implementation of a transparent mechanism for budget preparation based on the existing budget preparation framework.</p> <p>Strengthen and adequately fund the judiciary, Attorney General, Auditor General, Ombudsman, Police, and the Committee on the Independent Commission Against Corruption (ICAC) to enable them to carry out their functions in an effective manner.</p>	<p>Occurrence (or lack thereof) and severity of end-of-year fiscal blowouts.</p> <p>Occurrence and severity of off-budget allocations and impact on availability and expenditure of resources in social sector and infrastructure.</p> <p>FY2000 and subsequent budgets are prepared in full consultation with concerned departments and in conformity with existing budget preparation procedures.</p> <p>Adequate budgetary allocations for all agencies with oversight responsibility.</p>	<p>Policy dialogue is established along the lines of CEM findings and recommendations.</p> <p>Level at which structural reforms are built into the budget and consolidated through the administrative and legal framework.</p> <p>Depth of reforms achieved through the adjustment operation.</p> <p>ICAC or similar mechanism established and operational with appropriate funding to address issues of corruption and abuse of power, by June 2000.</p> <p>Engagement on governance and corruption issues leads to tangible progress in dealing with the Rural Development Fund in particular and discretionary funding in general, by June 2000.</p>	<p><u>Analytical and Advisory</u></p> <ul style="list-style-type: none"> • Country Assistance Strategy (CAS) • Country Economic Memorandum (CEM) • Structural Policy Review (SPR) • Country Procurement Assessment Report (CPAR) • Public Expenditure Review (PER) • Country Portfolio Performance and Implementation Review (CPIR) • Decentralization and Service Delivery <p><u>Lending and TA</u></p> <ul style="list-style-type: none"> • Structural Adjustment Loan (Base case) • IDF for Independent Commission Against Corruption (ICAC) 	<ul style="list-style-type: none"> • AusAID • Asian Development Bank (ADB) • IMF • UN Agencies

	DIAGNOSIS	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
	<p>In addition to serious fiscal impacts, dramatic increases in discretionary funds to Members of Parliament through District Support Grants (and others) are perpetuating a view that politicians are self-serving and prone to corruption.</p> <p>There is a lack of coordination among those responsible for decentralization and provincial reforms, confusion on the roles and responsibilities of various departments and a reduced emphasis on the provincial reforms in light of other pressures and priorities.</p> <p>Quasi-fiscal manipulations associated with state-owned financial institutions are undermining the good governance of the financial system.</p>	<p>Cooperation between the Auditor-General's (Au-G) department and Attorney General (At-G) must be strengthened such that reports prepared by the Au-G are acted upon by the At-G and, as appropriate, the Ombudsman Commission</p> <p>Discretionary funds for Members of Parliament is sharply curtailed and made subject to scrutiny of the budget process, with the ultimate objective of eliminating it completely.</p> <p>A workable decentralization model needs to be developed and piloted in 2 to 3 provinces where the absorptive capacity and administrative infrastructure are sufficient.</p> <p>Fully account for, and make subject to parliamentary approval, all resource transfers within the enlarged PNGBC group.</p>	<p>Comprehensive strategy introduced to enhance complementarity and ensure expeditious implementation of findings.</p> <p>The allocation for MPs under the District Support Grant and Office of Rural Development is reduced from K1,500,000 per annum to K150,000 or less in 2000 and transparent procedures are instituted to ensure regular, comprehensive documentation of spending by end 1999. A plan is then adopted to eliminate such discretionary grants for 2001.</p> <p>Percent of budget assigned to member of parliament for discretionary use or for channeling through other means such as the newly established Office of Rural Development is reduced.</p> <p>A decentralized regional development strategy is prepared and implemented in 2 to 3 provinces on the basis of a fully decentralized administrative structure</p> <p>An action plan for the privatization of PNGBC should be developed and adopted by June 2000.</p>	<p>Key Issues and/or Objectives</p>		

Key Issues and/or Objectives	DIAGNOSIS	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
<p>A-2 – Reestablish macroeconomic stability and implement measures which will reduce PNG’s vulnerability to external shocks, effectively enhancing sustainability of macroeconomic stability</p>	<p>The macroeconomic situation continues to deteriorate. A confidence crisis is fueling capital outflows which is putting balance of payments under pressure. Efforts to support the exchange rate have failed and severely depleted reserves. Depreciation of the Kina is increasing CPI inflation to highest recorded levels. Sustainability of stability will depend on the Government’s willingness and capacity to implement fundamental structural reforms to minimize the economy’s vulnerability to internal and external shocks.</p> <p>There is a looming fiscal crisis if fiscal management is not urgently cleaned-up and the 99 budget reassessed on the basis of more realistic assumptions</p>	<p>Tighten fiscal management and eliminate the growing fiscal imbalance.</p> <p>BPNG should not loosen monetary stance prematurely.</p> <p>Currency reserves are rebuilt, easing pressure on the Kina.</p> <p>The Government should redraw a more prudent and realistic budget which is introduced as a Supplementary Budget.</p> <p>GOPNG should reengage the Bank and IMF in a more constructive dialogue in order to avoid using expensive external borrowing, which is unlikely to bring any long term structural improvements.</p>	<p>Overall fiscal deficit is kept at a sustainable level of no more than 1% of GDP in 1999 and balanced budgets for 2000 and 2001 (exclusive of extraordinary revenues)</p> <p>Interest rates are maintained positive in real terms throughout the period.</p> <p>Inflation is reigned-in to the low single-digit range.</p> <p>Supplementary Budget is approved by Parliament and implementation proceeds in a transparent manner.</p> <p>Dialogue with Bank and IMF on macroeconomic issues is reestablished in a transparent and constructive forum. Economic data and reports are provided by GOPNG in a timely fashion.</p>	<p>Policy dialogue is established along the lines of CEM findings and recommendations.</p> <p>Level at which structural reforms are built into the budget and consolidated through the administrative and legal framework. Depth of reforms achieved through the adjustment operation.</p>	<p>Analytical and Advisory</p> <ul style="list-style-type: none"> • Country Economic Memorandum (CEM) • Structural Policy Review (SPR) <p>Lending and TA</p> <ul style="list-style-type: none"> • Structural Adjustment Loan (Base case) 	<ul style="list-style-type: none"> • AusAID • IMF • ADB

Key Issues and/or Objectives	DIAGNOSIS	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
<p>A.3 – Reestablish integrity of budget and financial management policies and procedures to enhance operational effectiveness and streamline decentralization efforts</p>	<p>Basic budget and financial management procedures present a range of deficiencies (shortcomings or misapplications of legislative arrangements, inappropriate management practices and attitudes associated with the safeguarding of public funds) in the governance arrangements associated with the financial management of public funds by core agencies resulting in lack of credibility and little ownership.</p> <p>Present resource management system does not provide for adequate strategic input and fails to balance the short, medium and long-term needs of the country. Financial monitoring and control, transparency and integrity of the system have come under substantial pressure, particularly in view of the efforts to implement provincial and local level governments reform program.</p>	<p>The integrity of the budget cycle, which was seriously undermined in the 99 budget, must be reestablished through the proper functioning and due consideration of the Budgets Division of the Department of Treasury and Planning and proper inputs from concerned departments and agencies.</p> <p>Cash flow management system must be enhanced to improve the quality of forecasts for revenues and expenditures, including an upgrade of the warrant allocation system.</p> <p>Constraints on the effectiveness of the commitment, procurement and expenditure system must be removed so that budget allocations can be used effectively and in a timely manner.</p>	<p>The 2000 and subsequent budgets are prepared in full cooperation with concerned ministries and departments in line with practice existing before the 1999 budget.</p> <p>Budgets include the necessary level of details to allow for the proper allocation between personnel and recurrent expenditures.</p> <p>Budget preparation and implementation includes provisions for carry-overs and for cash flow management beyond one fiscal year.</p> <p>Adopt and implement a budget and financial monitoring system at the national and provincial levels. The system should be able to monitor outcomes in social services, physical infrastructure services and agricultural services against standards and indicators.</p>	<p>Level at which CEM recommendations have been adopted in revised budgetary and fiscal management procedures.</p>	<p><u>Analytical and Advisory</u></p> <ul style="list-style-type: none"> • Country Economic Memorandum (CEM) • Structural Policy Review (SPR) • Country Procurement Assessment Report (CPAR) • Decentralization and Service Delivery • Public Expenditure Review <p><u>Lending and TA</u></p> <ul style="list-style-type: none"> • Structural Adjustment Loan (Base case) 	<ul style="list-style-type: none"> • AusAID • ADB • IMF • UNDP

Key Issues and/or Objectives	Diagnosis	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
A.4 - Improve transparency, independence and effectiveness of monetary management in order to restore confidence in the banking and financial sectors	<p>Interference in the management of BPNG has eroded BPNG's authority and ability to maintain monetary stability and weakened its independence.</p> <p>There has been a surge in public expenditures leading to domestic arrears, heavy borrowing from BPNG increasing its exposure to government substantially, now exceeding the maximum exposure level.</p> <p>The BPNG does not have the legal authority or the technical expertise to supervise the new PNGBC conglomerate group and its overall effectiveness in providing financial sector oversight is weak.</p>	<p>In line with IMF recommendations, BPNG Act should be amended to protect management authority from political influence.</p> <p>BPNG credit to government must be brought back within the statutory limit in order to allow for adequate rate of growth of credit to the private sector without further fueling inflation.</p> <p>BPNG Act should be amended to strengthen BPNG's supervisory powers.</p>	<p>Amendments to BPNG Act are completed by end of 2000.</p> <p>Credit to Government back within statutory limits by end of 1999 and stay within limits for the CAS period.</p> <p>BPNG develops, announces and implements bank supervisory program by end of 2000.</p>	<p>Policy dialogue is established along the lines of CEM findings and recommendations.</p> <p>Performance on macro targets and overall IMF program and depth of reforms pursued and achieved through the adjustment operation, by December 2000.</p>	<p>Analytical and Advisory</p> <ul style="list-style-type: none"> Country Economic Memorandum (CEM) Structural Policy Review (SPR) Country Procurement Assessment Report (CPAR) Decentralization and Service Delivery Public Expenditure Review <p>Lending and TA</p> <ul style="list-style-type: none"> Structural Adjustment Loan (Base case) Financial Sector Reform (Base case) 	<ul style="list-style-type: none"> AusAID IMF
A.5 - Implement public sector reforms, including rationalization of public sector enterprises	<p>The structure and size of the public sector must be rationalized in order to achieve a more effective framework for the carrying out of policy and program implementation. The ongoing retrenchment program has been hastily planned and involves the abolition of a number of vital PNG institutions.</p> <p>Although public enterprises have claimed a sizable share of public resources, the quality of services, particularly electricity and water supply, has deteriorated in recent years.</p>	<p>Elaborate a realistically costed, adequately funded and properly phased public service reform plan while taking into account the findings and recommendations of the PER.</p> <p>Prepare a comprehensive three-year plan to rationalize, restructure, corporatize, or privatize state-owned enterprises and statutory authorities.</p>	<p>Core PNG institutions eliminated under the 1999 budget are restored and adequately funded.</p> <p>Progress on implementation of adjusted public sector reform program and PER recommendations.</p> <p>Complete the preparation of a privatization strategy.</p> <p>Successfully completed the privatization of 4-5 state-owned enterprises, including one large utility.</p>	<p>Through provision of technical assistance, sustained dialogue on the privatization front leading to a transparent privatization program.</p>	<p>Analytical and Advisory</p> <ul style="list-style-type: none"> Country Economic Memorandum (CEM) Structural Policy Review (SPR) Decentralization and Service Delivery Public Expenditure Review IFC Privatization Assistance <p>Lending and TA</p> <ul style="list-style-type: none"> Structural Adjustment Loan (Base case) Public Sector Reform/Civil Service Development (High case) 	<ul style="list-style-type: none"> AusAID ADB

Key Issues and/or Objectives	Diagnosis	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
A.6 - Improve the business environment in order to stimulate the private sector	<p>Macroeconomic weakness and recent political instability have eroded business confidence and significantly reducing the level of domestic and international investment in PNG.</p> <p>Nascent SME sector requires assistance in project development and funding.</p>	<p>Implement macroeconomic stabilization program as outlined under A.2. Easing of monetary policy can then be considered in light of results of macroeconomic stabilization.</p> <p>Continuation of SPPF's PNG office and regular visits by investment officers.</p>	<p>Non-mining GDP growth rate of 2-3% per year during the CAS period.</p> <p>Performance in implementing stabilization program.</p> <p>Number of applications received and reviewed by SPPF officers</p> <p>Strategy to begin addressing law and order problem is adopted.</p>	<p>Effective consultations with business community on the objectives of the adjustment program.</p> <p>Successful engagement of the business community in dialogue on governance and corruption, leading to stronger ownership of the issue.</p> <p>Increase in number of SPPF-supported projects that receive project financing.</p>	<p>Analytical and Advisory</p> <ul style="list-style-type: none"> Country Economic Memorandum (CEM) Structural Policy Review (SPR) SPPF Advisory Services <p>Lending and TA</p> <ul style="list-style-type: none"> Mineral and Gas Sector Technical Assistance (Low case) Structural Adjustment Loan (Base case) 	<ul style="list-style-type: none"> AusAID ADB IMF
B. Supporting Rural Development						
B.1 - Strengthen the institutions responsible for delivery of basic public services at national and provincial	<p>The quality of the civil service has deteriorated in the past decade, adversely affecting the capacity to deliver services to the rural population.</p> <p>Progress in decentralizing manpower to the provinces and rural areas where the majority of the population lives has been slow.</p>	<p>Rationalize organizational structure of civil service to facilitate clear role definition and establish lines of responsibility.</p> <p>Reform and restructure the public service in light of the renewed Government's focus on service delivery.</p>	<p>Recurrent and development budgets are consistent with stated sectoral strategies and objectives.</p> <p>Improved fiscal planning and financial management/ reporting in the provinces, with training in key skill areas and increase the number of key functionaries in provincial areas.</p>	<p>Elements to streamline decentralization identified and implemented through the SAL.</p>	<p>Analytical and Advisory</p> <ul style="list-style-type: none"> Country Economic Memorandum (CEM) Structural Policy Review (SPR) Decentralization and Service Delivery Public Expenditure Review <p>Lending and TA</p> <ul style="list-style-type: none"> Structural Adjustment Loan (Base case) Public Sector Reform /Civil Service Development (Base case) 	<ul style="list-style-type: none"> Australia ADB

Key Issues and/or Objectives	DIAGNOSIS	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
B.2 - Improving basic health services	<p>Inadequate funding, inappropriate staffing, insecurity and untimely release of budgetary funds have resulted in closing of many aid posts.</p> <p>Substantial delays in procurement of essential drugs in adequate supplies.</p> <p>Poor reproductive health status and incidence of AIDS and other STDs has risen sharply.</p>	<p>Implementing the National Health Plan with special emphasis on rural access to health services.</p> <p>Coverage and timely availability of essential drugs is improved by privatizing the supply function and increasing the budgetary allocations.</p> <p>Improved access to preventive health services (maternal health, family planning and reproductive awareness programs), especially at the periphery.</p> <p>Intensifying public awareness and education programs and provide adequate funding.</p>	<p>Coverage and delivery of primary health services improve in line with established benchmarks each year.</p> <p>Maternal health care programs under the Population and Family Planning Project is expanded to other provinces.</p> <p>Child mortality rate begins to drop by 2002.</p> <p>Increased awareness of AIDS/STDs and prevention measures (to be measured through next household survey).</p>	Continued participation in health sector strategy development.	<p>Analytical and Advisory</p> <ul style="list-style-type: none"> Country Economic Memorandum (CEM) Structural Policy Review (SPR) Public Expenditure Review (PER) Country Portfolio Performance and Implementation Review (CPIR) Decentralization and Service Delivery Rural Development and Agriculture Strategy <p>Lending and TA</p> <ul style="list-style-type: none"> Population and Family Planning (On-going) El-Nino Drought Recovery (On-going) Structural Adjustment Loan (Base case) 	<ul style="list-style-type: none"> AusAID ADB EU (water supply) Japan (water supply and infrastructure) New Zealand UN Agencies

Key Issues and/or Objectives	DIAGNOSIS	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
<p>B.3 - Improving access to basic education, with a particular focus on girls' education, in order to raise the level of national and functional literacy</p>	<p>Low enrollment ratios and high dropouts, particularly at secondary level and for female students.</p> <p>Limited access to educational facilities for females.</p>	<p>Improve the relevance of the curriculum to job requirements and national development strategy.</p> <p>Introduce strategy to enhance access for (and retain) female students at both primary and secondary schools.</p>	<p>The new revised curriculum is introduced progressively and completed by 2002.</p> <p>Increase enrollment ratio for girls at primary level from 67 to 70 percent by 2002, and at secondary school from 10 to 15 percent by 2002.</p> <p>Procurement of books under Education Development Project completed by 2002.</p>	<p>Suspension of the Education Development Project is lifted, by December 1999.</p> <p>Procurement of books is completed in accordance with revised project schedule.</p> <p>Bank maintains advisory role in education sector strategy development.</p>	<p><u>Analytical and Advisory</u></p> <ul style="list-style-type: none"> • Structural Policy Review (SPR) • Country Procurement Assessment Report (CPAR) • Public Expenditure Review (PER) • Country Portfolio Performance and Implementation Review (CPIIR) • Decentralization and Service Delivery <p><u>Lending and TA</u></p> <ul style="list-style-type: none"> • Education Development Project (On-going) • Structural Adjustment Loan (Base case) • Education Sector Reform (High case) 	<ul style="list-style-type: none"> • AusAID • ADB • New Zealand • UN Agencies

Key Issues and/or Objectives	Diagnosis	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
<p>B.4 - Improving supply response in the agriculture sector.</p>	<p>The supply response in the agricultural sector has been marginally positive but not adequate to ease up the unemployment problem and reduce rural poverty.</p> <p>Inadequate agricultural extension and research service, and constrained marketing.</p> <p>Constrained rural credit, especially for smallholders.</p>	<p>Maintaining a market determined exchange rate and removing excessive protection for agricultural commodities.</p> <p>Increasing the budgetary allocations for agriculture, rural transport, and road maintenance.</p> <p>Liberalizing agricultural produce processing and marketing activities, abattoirs, and coastal shipping.</p> <p>Improving availability, quality and scope of financial services in the rural areas, particularly for women.</p> <p>Resolve the agricultural debt overhang by honoring the government guarantee to banks on such debt and redeem it at face value</p>	<p>Tariff rates for agricultural commodities are rationalized to reduce the rate of domestic protection.</p> <p>Regulations relating to agricultural marketing are removed, namely the licensing of businesses and public sector trading in vegetables and livestock.</p> <p>Budgetary allocations for agriculture research, extension, and marketing, and rural development increases by 5 percent a year in real terms.</p> <p>Required amendments to the relevant legislation are introduced by 2000.</p> <p>Government adopts a strategy to improve the delivery of informal and rural credit by 2001.</p> <p>Rural development bank is restructured, recapitalized and reinvigorated.</p>	<p>Rural Development Strategy is completed and used as the basis for reinvigorating agriculture sector discussions with PNG and development partners, by June 2001.</p>	<p>Analytical and Advisory</p> <ul style="list-style-type: none"> • Country Economic Memorandum (CEM) • Structural Policy Review (SPR) • Public Expenditure Review (PER) • Decentralization and Service Delivery • Rural Development and Agriculture Strategy <p>Lending and TA</p> <ul style="list-style-type: none"> • Oro Small Holder Oil Palm (On-going) • Structural Adjustment Loan (Base case) • Community-Based Rural Development (High case) 	<ul style="list-style-type: none"> • ADB • EU • Japan • New Zealand • UN Agencies

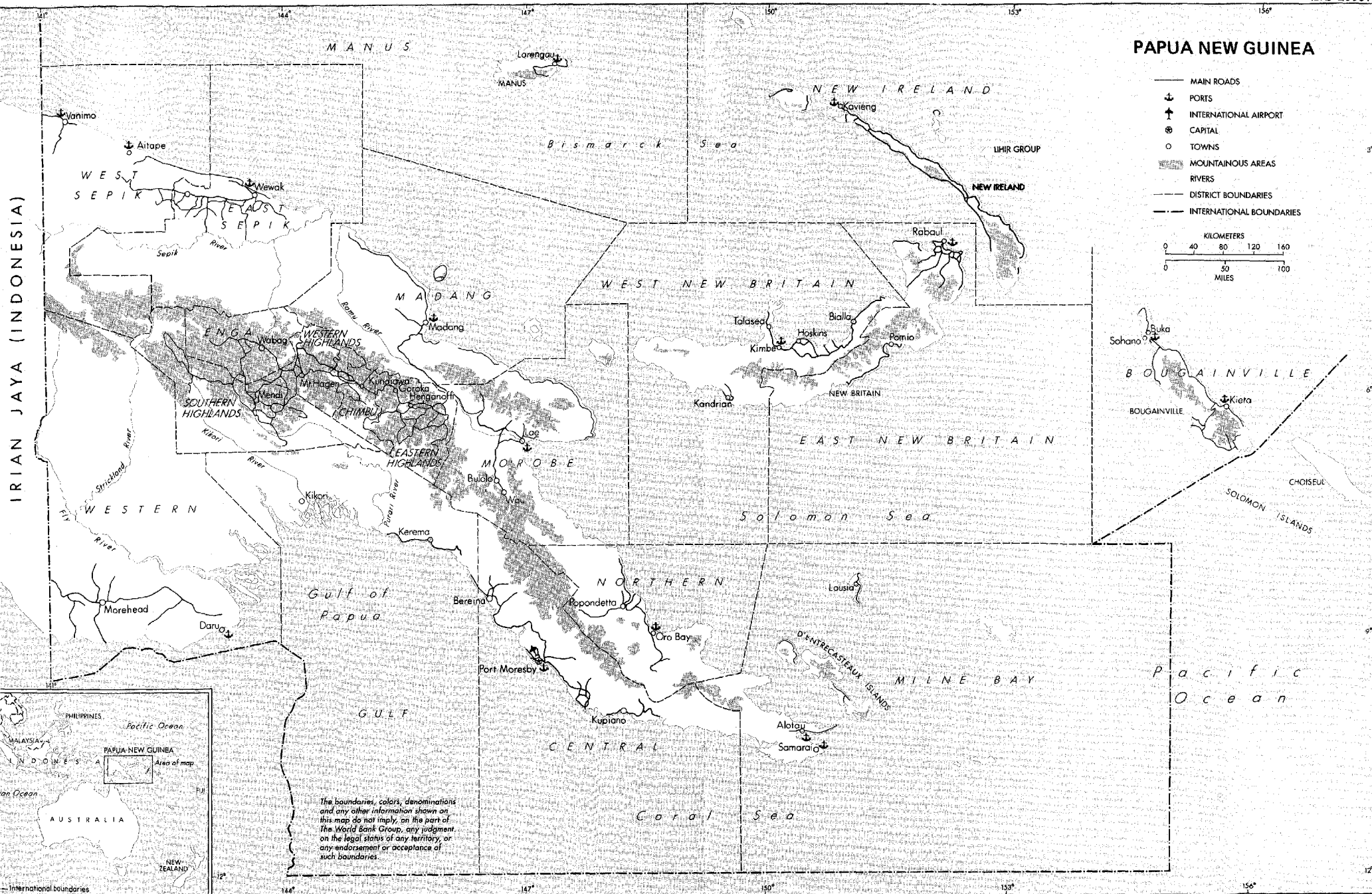
Key Issues and/or Objectives	Diagnosis	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
<p>B.5 – Improve the quality and reliability of the country's infrastructure, particularly the provincial and rural road network, to allow for more cost effective movement of goods and service and promote economic development in rural areas</p>	<p>Poor quality of the very limited road network and the limited access (particularly in rural areas) has hampered economic development and significantly increased the cost of service delivery and commercial activities.</p>	<p>Improve the capacity of agencies responsible for planning and maintenance of the road network and accelerate implementation of cost-effective management and maintenance procedures.</p> <p>Make road maintenance and rehabilitation a priority through improved infrastructure management and resource allocation.</p> <p>Upgrade the quality and coverage of the road network, especially in the most populous and productive areas.</p>	<p>Adoption of strategy to establish national and provincial road user networks to complement and support Government's efforts by 2000.</p> <p>Corporatization of Road Transport Authority by 2000.</p> <p>Budget allocation to road maintenance is consistent with stated strategy of enhanced road asset management.</p> <p>Conditions to reactivate preparation of the Road Maintenance and Rehabilitation Project are met.</p>	<p>Dialogue on road maintenance is reestablished, leading to the reappraisal of the Road Maintenance and Rehabilitation Project.</p> <p>Implementation of the Second Gazelle Rehabilitation Loan proceeds in accordance with Implementation Plan. PHRD for Highlands Highway is reactivated, by December 1999. Agreement is reached on roles of funding agencies and financial structure of the Highlands Highway Rehabilitation project, by December 2000.</p>	<p><u>Analytical and Advisory</u></p> <ul style="list-style-type: none"> • Country Economic Memorandum (CEM) • Structural Policy Review (SPR) • Country Procurement Assessment Report (CPAR) • Public Expenditure Review (PER) • Decentralization and Service Delivery • Rural Development and Agriculture Strategy <p><u>Lending and TA</u></p> <ul style="list-style-type: none"> • Second Gazelle Rehabilitation Loan (Low case) • Highlands Highway Rehabilitation (Low case) • Structural Adjustment Loan (Base case) • Road Maintenance and Rehabilitation (Base case) • PHRD for Highlands Highway (On-going) 	<ul style="list-style-type: none"> • AusAID • ADB • Japan

Key Issues and/or Objectives	Diagnosis	Strategy/Action	Progress and Output Indicators	Bank Benchmarks	Bank Group Instruments	Major Partners
<p><u>B.6 – Promote protection of the environment, sustainable management of forest resources and conservation of ecosystems and biodiversity for the purpose of sustainable rural development and environmental and cultural conservation</u></p>	<p>For most villages, conservation and sustainable use of natural resources provide the best (and sometimes only) opportunity for economic diversification, protection from destructive large scale logging activities and conservation of cultural heritage.</p> <p>The basis for sustainable forestry is being undermined due to pressure by the vested interest groups and recent backsliding on a number of issues. Further actions are required to strengthen sustainability of resource management while protecting key conservation areas.</p>	<p>Promote decision-making at the local level and community-based development strategies.</p> <p>Introduce alternative systems of forest resource management, including activities that generate income from a standing forest as well as source of income and employment for the landowners.</p> <p>All concessions and extensions to existing concessions must be tendered in accordance with forestry legislation and regulations.</p> <p>Protecting the independence of the National Forestry Board and strengthen the Forests Authority to enforce the implementation of the Forestry Code of Conduct and forestry regulations on the ground.</p>	<p>A satisfactory definition of sustainable harvesting in accordance with FCP legal framework will have been established, including national standards for independent inspection and reporting of results to government agencies, private sector and civil society.</p> <p>All new concessions now under consideration through streamlined procedures (fast track) are withdrawn or resubmitted in accordance with established procedure.</p> <p>Regulations should be amended to provide for a maximum size of an extension.</p> <p>Forestry Act remains unchanged to protect the integrity and independence of the National Forests Board.</p>	<p>Policy dialogue on forestry reestablished through resolution of outstanding issues on extensions, fast-tracking and resource administration, by March 2001.</p> <p>Forestry and Conservation Project successfully negotiated and presented to the Board.</p> <p>Models of community-based development and resource management are developed, documented and considered in rural development strategy and future rural development investment operations.</p>	<p><u>Analytical and Advisory</u></p> <ul style="list-style-type: none"> • Country Assistance Strategy (CAS) • Country Economic Memorandum (CEM) • Structural Policy Review (SPR) • Public Expenditure Review (PER) • Rural Development and Agriculture Strategy • Environment Strategy Note <p><u>Lending and TA</u></p> <ul style="list-style-type: none"> • Forestry and Conservation Project (Low case) • Structural Adjustment Loan (Base case) • Community-Based Rural Development (High case) • PHRD for Forestry and Conservation Project • GEF Enabling Activity • National Forest Conservation Action Plan (NFCAP) Trust Fund 	<ul style="list-style-type: none"> • AusAID • EU • GEF • Japan • New Zealand • UN Agencies • NGOs (local/international)

ANNEX B10: CAS SUMMARY OF DEVELOPMENT PRIORITIES

Network Area	Country Performance	Major Issue (s)	Country Priority	Bank Priority	Reconciliation of Country and Bank Priorities
Poverty Reduction & Economic Management					
• Poverty reduction	Poor	Widespread rural poverty, governance, fiscal management.	Low	High	Ongoing dialogue, focus on service delivery, good governance and fiscal management.
• Economic policy	Fair	Governance and implementation.	High	High	
• Public sector	Fair	Size, effectiveness.	High	High	
• Gender	Poor	Education, violence.	Low	Moderate	Ongoing dialogue. Targeted efforts in sector lending.
Human Development Department					
• Education	Fair	Enrollment, attainment, girls participation.	Moderate	High	Focus on implementation effectiveness and dialogue on sector reforms.
• Health, nutrition & population	Poor	Service delivery, resource availability.	Moderate	High	Other donors taking lead.
• Social protection	Poor	Poor service delivery.	Low	Moderate	Focus on service delivery through institutional development.
Environmentally & Socially Sustainable Development					
• Rural development	Poor	Low level of infrastructure, low participation of local level decision-makers.	Low	High	Rural development must be linked to overall economic development.
• Environment	Fair	Sustainable use of resources, commercial/industry pressures.	Moderate	High	Ongoing dialogue. Focus on policy issues and sustainable use of resources.
• Social development	Poor	Service delivery.	Low	Moderate	Ongoing dialogue
Finance, Private Sector & Infrastructure					
• Financial sector	Fair	Lack of transparency, state-owned financial institutions.	Low	Moderate	Ongoing dialogue to improve transparency and governance.
• Private sector	Fair	Weak macroeconomic environment, competitiveness.	Moderate	Moderate	
• Energy & mining	Good	Redistribution of wealth and reinvestment of windfalls in human development.	High	Moderate	Sector heavily promoted by country. Private sector taking lead in resource development. Bank's focus on proper use of windfalls and revenues.
• Infrastructure	Poor	Maintenance of capital assets, planning of infrastructure projects, governance.	Moderate	High	Lending focused on maintenance and rehabilitation.

MAP SECTION



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