



National Economic and Fiscal Commission

**2009 Budget
Fiscal Report**

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FOREWORD

It gives me great pleasure to present this first ever fiscal report as required under Section 69 of the proposed *Intergovernmental Relations (Functions and Funding) Act 2008*. The new Act contains details of the new intergovernmental financing arrangements. The framework of broad principles are found in the *Organic Law on Provincial and Local-level Governments* which was recently amended by Parliament on 16th July 2008.

The fiscal report provides the “how” and “why” of the distribution and level of funding to Provincial Governments and Local-level Governments in the 2009 budget.

The report includes:

- a Ministerial Determination in relation to the apportioning of the annual equalisation amount.
- NEFC’s recommendation of the individual provincial share and individual Local-level Government shares.
- The functions and administration grant determination made by the Minister for Treasury
- NEFC’s reporting on provincial expenditures, revenues and other information on intergovernmental financing.

Apart from the reporting requirements as described above, we have explained in a little more detail how the new system works. In particular, the report describes how the costs of service delivery are estimated and how revenues are assessed. The report also demonstrates how funding for Provincial Governments and local level governments has been distributed on a needs basis. Finally, the report provides a brief summary of expenditure by Provincial Governments in 2006.

The overall objective is to ensure that Provincial Governments receive adequate funding so that minimum essential services such as rural health and basic education are delivered. Whilst we have attempted to ensure that the appropriate funding arrangements are in place, it is now incumbent on Provincial Governments and Local-level Governments to direct these towards their intended purposes.

It is also important that other government agencies responsible for building capacity and monitoring performance play their part in ensuring that Provincial Governments are adequately equipped to manage the additional funding now made available in the new system.

This report complements the 2005/2006 Provincial Expenditure Review Reports and the 2004-2007 Provincial Revenue Report that we have already released. The publication of these reports gives the public the most comprehensive information available on how much revenue Provincial Governments have received and what they have expended this on. Finally, the fiscal report also serves the purpose of ensuring there is transparency and accountability in the way public funds are used and managed in the provinces.



Nao Badu
Chairman & Chief Executive Officer

EXECUTIVE SUMMARY

The former system of intergovernmental financing was not effective. One of the reasons is that the rate of funding was fixed in the legislation without taking into account the large differences in both the cost of delivering services and level of revenues across the provinces. A new system that is fairer and more equitable was then developed and passed by Parliament on 16 July 2008. Under the new system, the amount of funding to be shared amongst Provincial and Local-level Governments (the equalisation amount) will be based on a percentage of resources available to the government. In the new system, this is referred to as Net National Revenue (NNR), which is the total tax revenue received by the government after excluding mining and petroleum revenue.¹

The Minister for Finance & Treasury then makes a determination on the apportionment of the equalisation amount between Provincial and Local-level Governments. In the Ministerial Determination for 2009, the equalisation amount is equal to K177.3 million. The determination provides for a guaranteed amount for each Provincial and Local-level Government, the equivalent of K100.9 million for Provincial Governments and K39.0 million for Local-level Governments. These guaranteed amounts are necessary as all Provincial and Local-level Governments, will for the first five years of the new system, not receive less than what they received in the 2008 budget. It also provides for the balance of the funds (K37.5 million) to be made available for distribution amongst the Provincial and Local-level Governments on a needs basis.

Following the determination, the NEFC calculates and recommends to the Treasurer individual allocations for each Provincial and Local-level Government (called the individual province share or individual local level share), along with recommended allocations for the different service delivery function grants. These are then provided to the Provincial Governments by Treasury for the purpose of preparing their 2009 budgets. Provinces are then given the opportunity to vary the distribution of these funds among the different function grants, but only within the total overall amount for that province. Once this process of negotiation is completed, the Minister for Treasury issues the Function and Administration Grants Determination that locks in the level and distribution of funding for each province for 2009.

The main feature of the new system is that funding is distributed on a “needs” basis. “Needs” refers to the difference between a province’s revenue and the costs of delivering basic services (costs minus revenue = need).

In determining the “need” of a province, all revenues received must be counted. The main sources of revenue in a province are national government grants, GST, licences, fees, taxes, commercial activities, mining and petroleum royalties and dividends. For the purpose of calculating grants, NEFC assessed revenue for 2009 at K310.1 million. Western and Morobe provinces are the highest revenue earners with K60.4 million and K44.4 million respectively while Manus and Oro provinces at the other end with K2.7 million and K4.5 million respectively.

NEFC’s estimate of the cost of delivering basic services in each province are based on the work done in the 2005 costs of services study. The costs estimated are only those related to recurrent goods and services and exclude personnel emoluments and development expenditures. The study involved an in-depth review of what and how much the provinces should be spending to ensure service delivery takes place in the vital MTDS sectors in the rural areas.

¹ The percentage that is applied to the NNR will gradually increase from 5.12% in 2009, to 6.57% by 2013 when the system will be fully operational.

The estimated total cost of delivering a basic level of services in the provinces, districts and local governments is K512.1 million (in 2009 prices). This includes the costs of recurrent goods and services for transport infrastructure maintenance, education, health/HIV, agriculture, village courts and administration. This is against a projected total revenue envelope for the provinces and Local-level Governments in 2009 of K408.3 million.

After estimating the costs of services and assessed revenue, the fiscal needs of a province and a Local-level Government is calculated. This is defined as the difference between estimated recurrent cost and assessed revenue.

In addition to work on cost of services NEFC, together with the Provincial and Local-level Service Monitoring Authority (PLLSMA) is concerned about the lack of a clear assignment of service delivery functions and responsibilities of Provincial and Local-level Governments. A PLLSMA sub-committee is finalising a review on function assignment in order to have a clear understanding on the distribution of responsibilities among the three tiers of government. This is to avoid confusion on who is responsible for what, and to ensure that funding follows function. The results of the review have been endorsed by PLLSMA and will be submitted to Cabinet for approval. The final product will be the issuance of a Governor-General's Determination, published in the Government Gazette early in 2009.

Under the legislation, the new system requires that monitoring and reporting of the expenditure on the different types of grants, including service delivery function grants take place. The normal process for this to happen is through Department of Treasury's quarterly budget reviews. Further details and clarification on monitoring and reporting responsibilities will be covered in the budget and expenditure instructions issued by the Secretary for Treasury. Among many other considerations, the instructions will also spell out the possible sanctions that can be imposed in the event that grants are not used as originally intended.

The recently launched 2006 Provincial expenditure review provides a comprehensive overview of expenditure of each province from all revenue sources. It reveals that whilst a number of provinces do not have sufficient funds to deliver a minimum level of basic services, every province has a priority gap in its expenditure. This means that funding for recurrent goods and services has been compromised in the name of funding for administration and capital and other projects. As an example, the review found that total spending on health and education decreased by K4 million from 2005 to 2006 while administration costs increased by almost K8 million for the same period. In terms of spending of internal revenue generated by provinces, two-thirds of these funds went to non-core priority areas in 2006.

TABLE OF CONTENTS

FOREWORD.....	I
EXECUTIVE SUMMARY	II
1 EQUALISATION AMOUNT	6
1.1 INTRODUCTION	6
1.2 2009 CALCULATION OF THE EQUALISATION AMOUNT	7
1.3 PROJECTIONS FOR EQUALISATION AMOUNT (2010-2013)	9
2 MINISTERIAL DETERMINATION (APPORTIONING THE EQUALISATION AMOUNT BETWEEN PROVINCIAL AND LOCAL- LEVEL GOVERNMENT)	10
2.1 INTRODUCTION	10
<i>Purpose</i>	10
<i>Legislative Provisions</i>	10
2.2 2009 MINISTERIAL DETERMINATION	11
<i>Equalisation Amount</i>	11
<i>Transitional Guarantees</i>	11
3 ESTIMATING COSTS	14
3.1 INTRODUCTION	14
<i>Why estimate costs?</i>	14
3.2 2009 MINISTERIAL DETERMINATION	14
<i>Summary of legislative provisions</i>	14
3.3 SERVICE DELIVERY FUNCTIONS AND RESPONSIBILITIES	15
3.4 NEFC COST OF SERVICES STUDY	15
<i>What was covered</i>	15
<i>How was it done?</i>	16
3.5 ESTIMATED COSTS FOR 2009	17
4 ASSESSED REVENUES.....	21
4.1 INTRODUCTION	21
4.2 SOURCE OF REVENUE DATA	21
<i>National goods and services grants</i>	21
<i>GST</i>	21
<i>Own-source revenue</i>	21
<i>Mining and Petroleum Royalties</i>	22
<i>Mining and Petroleum Dividends</i>	22
4.3 TYPES OF REVENUE	22
4.4 HOW ARE THE DIFFERENT REVENUES ASSESSED?	22
<i>Own Source Revenue</i>	22
<i>Royalties and Dividends from Mining/Petroleum projects</i>	23
<i>GST distribution</i>	24
<i>Bookmakers Tax</i>	26
4.5 2009 ASSESSED REVENUES	26
4.6 FISCAL NEEDS OF PROVINCIAL AND LOCAL-LEVEL GOVERNMENTS	29
5 FISCAL NEEDS AMOUNTS FOR PROVINCIAL AND LOCAL LEVEL GOVERNMENTS	30
5.1 FISCAL NEEDS AMOUNTS FOR PROVINCIAL GOVERNMENTS	30
5.2 FISCAL NEEDS AMOUNTS FOR LOCAL LEVEL GOVERNMENTS	30
6 INDIVIDUAL PROVINCE SHARE.....	32
7 INDIVIDUAL LOCAL-LEVEL SHARE	34
8 FUNCTION AND ADMINISTRATION GRANTS DETERMINATION.....	36
8.1 THE FUNCTION AND ADMINISTRATION GRANTS DETERMINATION	36
8.2 SERVICE DELIVERY FUNCTION GRANTS	37
8.3 ADMINISTRATION GRANT	37
8.4 FUNDING MINIMUM PRIORITY ACTIVITIES FOR SERVICE DELIVERY FUNCTION GRANTS.	37

8.5	CONDITIONS OF FUNDING AND EXPENITURE MANAGEMENT OF SERVICE DELIVERY FUNCTION GRANTS AND ADMINISTRATION GRANT	38
9	MONITORING AND REPORTING ON EXPENDITURE	39
10	PROVINCIAL EXPENDITURE REVIEW – 2006	41
APPENDIX A	DETERMINATION APPORTIONING THE EQUALISATION AMOUNT.....	45
APPENDIX B:	FUNCTION AND ADMINISTRATION GRANTS DETERMINATION	47
APPENDIX C:	RESPONSIBILITIES SPECIFICATION EXERCISE MATRICES.....	51
APPENDIX D:	EXPLANATORY NOTE ABOUT THE COSTING STUDY	60
APPENDIX E:	GRANT CALCULATION IN 2009 BUDGET PROCESS	63

1 EQUALISATION AMOUNT

1.1 Introduction

One of the weaknesses of the former system was that the amount of funding set aside for funding Provincial and Local-level Governments was fixed, irrespective of how much revenue the National Government received. Grants had become unaffordable and the National Government was forced to make ad hoc decisions about the amount of funding for grants. Then when grants once again became more affordable, funding was not increased as fast as it was reduced.

Clause 4 schedule 1 of the proposed *Intergovernmental Relations (Functions and Funding) Act* sets a minimum level of funding for the assigned service delivery functions and responsibilities of Provincial and Local-level Governments. This amount is referred to as the equalisation amount. The equalisation amount is then divided between individual Provincial and Local-level Governments in the later steps of grant calculation.

The equalisation amount is set by a formula based on a percentage of net national revenues (NNR). The NNR amount is the total tax revenue received by the National Government excluding mining and petroleum tax revenue. In general, the new system also uses actual data (as opposed to forecast) to determine amounts as this is considered more accurate. As such when the NNR amount for 2009 was calculated, actual 2007 revenue data was used.

This will provide greater certainty for Provincial and Local-level Governments as grants should remain affordable. If NNR is high, Provincial Governments and Local-level Governments will receive more funding, and if net national revenue is low, they will receive less funding. It will also ensure that the ratio of funding between the National Government and the other two levels of government (Provincial and Local-level Governments) will maintain some parity.

Further legislative provisions related to the calculation and process for determining the equalisation amount is described below. However, first, some further background is provided on how the percentage to be applied to net national revenues has been determined.

How was the percentage to be applied to NNR determined?

During the transition period (the first five years) some special transitional provisions apply. These are contained in schedule 1 of the proposed Act.

In the transition period, the equalisation amount is increased over the five years by increasing the percentage applied to NNR each year. To determine the funding levels for each year of the transition period, the percentage was increased in five even steps from the 2008 funding level of provincial and local-level governments as a percentage of NNR of 4.76% to the final percentage to be applied to NNR in the full system of 6.57%.

The following methodology was used to determine the 2008 funding level and final percentages to be applied to the NNR amount in the full system.

Current or additional funding	Calculation	Kina value in 2008	Value as % of NR (K2,942m)
Current funding: 2008 non-salary recurrent grants to Provincial and Local-level Governments (excluding Bougainville and NCD)	2008 Budget Appropriations	K124 million	4.21%
Current funding GST savings to National Government from new system	Difference between the GST National Government would have paid in 2009 under former system, and GST that would have been payable under new system	K 16 million	0.55%
Total current funding		K140 million	4.76%
Additional funding: from National Government	K50 million agreed for new system by NEC in 2006	K 53 million	1.80%
Total current and additional funding		K193 million	-
Percentage applied to net national revenue amount in full system		-	6.57%

The equalisation amount in each year of the transition period is calculated as follows:

Year	Rate
2009:	net national revenue amount X 5.12%
2010:	net national revenue amount X 5.48%
2011:	net national revenue amount X 5.84%
2012:	net national revenue amount X 6.21%
2013:	net national revenue amount X 6.57%

The result of this gradual increase in the percentage in five even steps is that the overall amount of funding available for Provincial Governments and Local-level Governments gradually increases.

1.2 2009 Calculation of the Equalisation Amount

The process for the calculation of the equalisation amount in the transition period is set out in Clause 4 of Schedule 1 to the proposed Act.

NEFC Calculation of the equalisation amount

The first step was for NEFC to prepare a written estimate of the equalisation amount for 2009 and provide the estimate to the Treasury Departmental Head on or before 31 March 2008.

The minimum funding level for the equalisation amount is calculated as a set percentage of the NNR amount.

Since the net national revenue amount needed to be calculated by the end of 31 March 2008 for the purposes of 2009 grants, the Act requires the NEFC to use the most recently available actual data from the most recent and complete fiscal year (the second preceding fiscal year).

Consistent with clause 4 of Schedule 1 of the proposed Act, the NNR amount for 2009 was calculated using tax revenue data from 2007 (the second preceding fiscal year) in accordance with the following formula.

General tax revenue for 2007	-	Mining and petroleum tax revenue for 2007	=	Net national revenue for 2009
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Where:-

“General tax revenue” is the total amount of tax revenue received by the National Government in the second preceding fiscal year; and

“Mining and petroleum tax revenue” is the total of the following amounts received by the National Government in the second preceding fiscal year:-

- (a) gas income tax within the meaning of the *Income Tax Act 1959*;
- (b) mining income tax within the meaning of that Act;
- (c) petroleum income tax within the meaning of that Act;
- (d) mining levy under section 160 of that Act for the fiscal year that commenced on 1 January 2006 and the fiscal year that commenced on 1 January 2007;
- (e) any other tax imposed in relation to any gas, mining or petroleum activity.

Actual outcomes for the National Government revenues were taken from Table 1 – Fiscal out-turn tables of the *2007 Final Budget Outcome* published by the Department of Treasury in March 2008.

The following table shows how the NNR amount for 2009 is calculated.

Act definition	Final Budget Outcome equivalents	Kina million
1. 2007 General tax revenue	Tax revenue	K5,853.8
MINUS (-)		
2. 2007 Mining and petroleum tax revenue	1. Mining and petroleum taxes	K2,333.9
	2. Mining levy	K56.6
	TOTAL	K2,390.5
EQUALS (=)		
3. 2009 Net National Revenue Amount		K3,463.3

In 2009, the minimum funding level for the equalisation amount is calculated according to the formula below in Kina million:

$$\begin{array}{rclclcl}
 \text{Net national revenue for 2009} & \times & 5.12\% & = & \text{NEFC estimate of} \\
 & & & & \text{2009 equalisation amount} \\
 \\
 \text{K3,463.3} & \times & 5.12\% & = & \text{K177.321}
 \end{array}$$

In accordance with the Act, the NEFC provided a written estimate of the equalisation amount to the Secretary for Treasury on 31 March 2008².

Final equalisation amount

On the receipt of NEFC's estimate of the equalisation amount, the Secretary for Treasury was informed that he could provide a higher estimate of the 2009 equalisation amount to the NEFC on or before 30 April if he was not satisfied with the NEFC's estimate.

If the Government wished to decrease the funding available to Provincial and Local-level Governments, the Parliament would need to amend the proposed Act and reduce the percentage applied to the NNR amount.

1.3 Projections for Equalisation Amount (2010-2013)

As noted above, the percentage that is applied to the NNR amount is gradually increased over the transition period. The result of this increase in the percentage used is that the overall amount of funding available for Provincial Governments and Local-level Governments increases each year over the first five years of the new system. This also reduces the annual budgetary impact of increased funding on both the National and Provincial Governments.

The following table provides preliminary projections of the estimated equalisation amount for 2009 to 2013 using data published in the 2008 Budget.

(In K'million)

	2009	2010	2011	2012	2013
General tax revenue (from second preceding year)	5,853.8	5,516.8	4,843.6	4,804.2	4,911.3
MINUS (-)					
Mining and Petroleum taxes (from second preceding year)	2,333.9	2,011.8	1,158.7	880.8	735.3
Mining Levy	56.6	15	0	0	0
EQUALS (=)					
NNR Amount	3,463.3	3,490	3,684.9	3,923.4	4,176
MULTIPLIED BY (x)					
Percentage to be applied to NNR Amount	5.12%	5.48%	5.84%	6.21%	6.57%
EQUALS (=)					
Equalisation Amount	177.3	191.3	215.2	243.6	274.4

² The Secretary for Treasury did not provide his own estimate of the equalisation amount to the NEFC. As a result, the NEFC used its own estimate of the equalisation amount for the purposes of the grant calculation.

2 MINISTERIAL DETERMINATION (APPORTIONING THE EQUALISATION AMOUNT BETWEEN PROVINCIAL AND LOCAL-LEVEL GOVERNMENT)

2.1 Introduction

Purpose

The reasoning behind the Ministerial Determination is that it is necessary to set aside four (two in the full system) separate funding pools for Provincial and Local-level Governments before these funding pools are separately divided by the NEFC among individual Provincial Governments and individual Local-level Governments on the basis of need.

Legislative Provisions

In the transition period (2009-2013), the proposed *Intergovernmental Relations (Functions and Funding) Act 2008*, states that the Minister for Treasury, in consultation with the NEFC will make a written determination specifying a provincial share, a local level share, total transitional individual province guarantees and total transitional individual local-level guarantees.

The provincial guarantees are provided to ensure no Provincial Government receives less funding than they did from grants and GST for each year of the transition period than they did in 2008.

The local level guarantees are provided to ensure that no Local Level Government receives less than its 2008 level of funding.

The provincial and local level share will be distributed to the Provincial Governments and Local Level Governments on an equalisation basis.

In the full system (2014 and beyond) there will be no more guarantees and the equalization amount will be split between the amounts for Provincial Governments and Local-level Governments.

The Ministerial Determination specifying the splits will remain in force at least for the whole transition period until revoked by the Minister. The NEFC will publish the Determination that is in force each year in the Annual Fiscal Report.

2.2 2009 Ministerial Determination

Equalisation Amount

In the first year of implementation of the equalisation system, the Treasurer makes a Ministerial Determination on the split of the equalisation amount of **K177,326,080** as follows;

<i>i Total amount for funding transitional individual province guarantees</i>	K'm
Amount appropriated for block grant, function grant and derivation grant for 2008	84.8
"GST" Guarantee in 2009	16.0
Total	100.9
<i>ii. Total amount for funding transitional individual local level guarantees</i>	
Receive their 2008 level of funding	39.0
<i>iii. Province share</i>	
Remainder – to be distributed on an equalisation basis.	33.9
<i>iv. Local level share</i>	
Remainder – to be distributed on an equalisation basis	3.5
Total	177.3

Transitional Guarantees

(i) Total of the transitional individual province guarantees of all Provincial Governments

Over the transition period, no Provincial Government will be worse off compared to 2008 funding levels. Each Provincial Government will receive a guaranteed amount equal to the sum of:

- 2008 block, function and derivation grant funding (K84.8 million for all provinces)
- if the GST distribution received by a Provincial Government in 2008 is greater than the GST distribution received in the transition period, the difference between the two GST distribution amounts will be given in the form of service delivery function grants.
 - Under the new system, Provincial Governments will only receive 60% of net inland GST collections from the "second preceding year."
 - At the moment, most Provincial Governments receive more than 60%.
 - For 2009, the amount 'converted' from GST transfers to service delivery grants is K16.0 million for all provinces.

- In 2009 total funding for transitional individual province guarantees for all provincial governments is K100.9 million.

(ii) Content of Determination part (i)

The total amount for funding transitional individual province guarantees is:

- K84,849,100: being the amount appropriated to all Provincial Governments in 2008 for block grants, function grants and derivation grants

PLUS

- For the relevant year of the transition period, the total of the following amounts for all Provincial Governments:
 - if the GST distribution received by a Provincial Government in 2008 is greater than the GST distribution received in the relevant year (2009) of the transition period.
 - The difference between the two GST distribution amounts will be allocated to Provinces as Service Delivery Grants.

(iii) Total of the transitional individual local-level guarantees of all Local-level Governments

During the transitional period, no Local-level Government will be worse off compared to 2008 funding levels.

- Each Local-level Government will receive a guaranteed amount equal to the 2008 amount for goods and services grant funding

(iv) Content of Ministerial Determination Part (ii)

In 2009, the proportion of the equalisation amount available for the total of the transitional individual local level guarantees is K38,984,200.

(v) Local Level Share

In comparison to Provincial Governments, Local-level Governments are over-funded in that they will receive 24% of the equalisation amount despite them only accounting for 14% of the total provincial and local level government costs of service delivery. That is Local-level Governments receive a higher proportion of funding relative to their costs than Provincial Governments.

However, it would not be realistic to freeze Local-level Government funding at 2008 levels as recurrent costs of increased district expenditure is expected to rise with the injection of the K10m provided under the District Service Improvement Programme.

Some individual Local-level Governments also do not currently receive enough funding, and we therefore need to provide some of the remaining equalisation amount to those Local-level Governments that need it.

Overall, Local-level Governments will receive additional funding of K3.5 million in 2009, or a 9% increase on 2008 funding levels.

(iv) Provincial Share

In the Ministerial Determination, the Province Share will be defined as all the remaining funding from the equalisation amount as shown below.

	<i>K'million</i>	<i>% of EA</i>
<i>Equalisation Amount (EA)</i>	<i>177.3</i>	<i>100%</i>
<i>(i) Total amount for funding transitional individual province guarantees</i>	<i>100.9</i>	<i>57%</i>
<i>(ii) Total amount for funding transitional local level guarantees</i>	<i>39.0</i>	<i>22%</i>
<i>(iii) Local level share – 2% of EA</i>	<i>3.5</i>	<i>2%</i>
<i>(iv) Province share – remaining funding from EA after paying (i), (ii) and (iii)</i>	<i>33.9</i>	<i>19%</i>

All these components are funded from the equalisation amount. To ensure there is sufficient funding available to meet all these components, the guarantees must be accounted for first. The remaining component is distributed on the basis of need.

The amount distributed on need will increase during the first five years of the new system to minimize large fiscal impacts on provinces and the National Government.

Written Determination issued by Minister

A copy of the determination is contained in Appendix A.

3 ESTIMATING COSTS

3.1 Introduction

Why estimate costs?

Since Provincial and Local-level Government grants are now being calculated on need basis, it is important to establish each Provincial and Local-level Governments revenues and costs. After determining these factors, NEFC would be in a position to:

- 1) determine the 'fiscal need' and
- 2) calculate the amount of grants for Provincial and Local-level Governments.

During the transition period of the new intergovernmental financing system, the estimated costs of assigned service delivery functions and responsibilities will be the *"estimate by the NEFC of the cost for the fiscal year to the Provincial Government of performing its service delivery functions and responsibilities. This includes the incidental costs of administration of the Provincial Government (whether or not the service delivery functions and responsibilities are assigned under Part 2 of the Act)"*

As a result, the NEFC is allowed to make its own estimate of the *estimated costs of assigned service delivery functions and responsibilities* in the absence of a Determination that clarifies the *assigned service delivery functions and responsibilities to the different levels of government*.

This Determination was not in place by the **31 May 2008** deadline for advising the Treasurer of the 'Individual Province Share'. Therefore, for the 2009 fiscal year, it was necessary for the NEFC to make its own assessment of the administration and service delivery costs and responsibilities of each Provincial Government.

The Provincial and Local-level Service Monitoring Authority (PLLSMA) sub-committee on Functions and Responsibilities Assignment is now working on refining the NEFC's initial findings and is aiming to produce this Determination by the end of 2008. It will then be available to be used for the 2010 budget.

3.2 2009 Ministerial Determination

Summary of legislative provisions

1. The *Organic Law on Provincial and Local-level Governments*

Part 4, Division 2, of the Organic Law explains the division and distribution of revenue among and between the levels of government and other financial arrangements.

These provisions are further explained in greater detail in the proposed *Intergovernmental Relations (Functions and Funding) Act 2008*.

2. *Intergovernmental Relations (Functions and Funding) Act 2008*

Part 2 of the proposed Act explains the principles and the circumstances under which service delivery functions and responsibilities assignment will be determined.

Part 3 explains the equalisation system of the new intergovernmental financing arrangements, which also clearly highlights the fiscal need basis upon which Provincial and Local-level Government grants will be calculated.

3.3 Service Delivery Functions and Responsibilities

As is required by law, the new intergovernmental financing arrangements will be based on assigned service delivery functions and responsibilities of Provincial and Local-level Governments. As a result, costs which NEFC uses for the fiscal needs calculation will be directly related to these functions and responsibilities.

As part of the review of intergovernmental financing arrangements, the NEFC conducted the Responsibilities Specification Exercise (RSE) in 2003. This exercise was undertaken to better understand the current situation regarding distribution of functions and responsibilities and attempt to clear up confusion about funding.

The PLLSMA sub-committee on Functions and Responsibilities Assignment is further developing that NEFC Responsibilities Specification, and refining outstanding issues. The sub-committee is aiming to finalise this Determination by the end of 2008 for use in preparing the 2010 budget.

For NEFC's purposes, "responsibility" and "function" for any course of action simply mean *who makes the decision* (legislation & policy), *who carries it out* (implementation), and *who pays* (resourcing).

During the RSE, the NEFC found that:

- there was no clear specification of responsibilities at each level of government/administration;
- there was confusion and different understandings among stakeholders at different levels on where some responsibilities 'belong' (e.g. funding);
- in relation to funding allocations, there may be different priorities and disagreements on appropriate levels of funding; and
- there were capacity constraints at every level, which hampered implementation.

The RSE attempted to demarcate policy planning and development, funding, and implementation responsibilities of all sectors at all levels of governments. The Cost of Services Study undertook a similar approach in establishing the different functions and activities carried out within a given sector by each level of government. The findings of these two major exercises were then amalgamated to truly reflect the proper functions and responsibilities of each level of government in all the sectors that were covered.

Appendix C shows the matrices outlining these findings.

3.4 NEFC Cost of Services Study

What was covered

The purpose of the Cost of Services Study was to examine in detail what Provincial and Local-level Governments ***should be spending*** if they are to deliver a basic level of services. It must be emphasised that this was not a study of what is currently being spent. Rather, the intention was to set a detailed benchmark for assessing how much needs to be spent, and on what.

The Cost of Services Study covered **recurrent, non-salary costs only**. It does not include public servants' or teachers' salaries and leave fares, and it also does not include any capital or development expenditure.

The primary focus of this phase of the costing study was on service delivery to the rural majority of PNG's population. **Urban services are of a different nature** and will be the subject of a separate study.

It was assumed that:

- the costing should relate to existing service delivery programs as sectors and levels of government understand they **should be** delivered.
- the costing should only relate to actual, existing and operational facilities and roads, and to current levels of staffing.
- the Costing Study was also based on a similar, standard set of services. This was done even though some provinces undertake some services and not others; in some the level of service is greater than in others. For example, the costing study estimated the cost of the standard level of immunisation patrols for all provinces even though some provinces did not meet that standard.

How was it done?

One of the primary objectives of the study was to accurately record the travel modes, routes and distances for each district, so that these costs can be more accurately calculated.

Travel routes between all service delivery points were marked on maps. The University of Papua New Guinea's Satellite Sensing Unit, using their Geographic Imaging System (GIS) technology plotted those maps and calculated the actual (Euclidean) distances. Using results of other independent studies on the various modes of travel e.g. walking, 4WD and 40 hp outboard motor, actual costs of travel were calculated.

In order to more accurately reflect the differences in costs between different provinces, the study used data on the actual cost of specific inputs that have been surveyed in each province. For example, district-specific fuel prices.

The study developed cost estimates based on inputs, rather than outputs. Therefore input-based standards to define the activity level for the costing were used. These were based on surveys of standards which provinces are attempting to implement, combined with discussions with the line agencies in each service delivery sector.

Once a reasonable level of detail had been worked out as to what services need to be delivered, what activities those involved, and what level of activity is required, the study specified the inputs required to carry out that particular service delivery activity.

The main inputs needed to carry out service delivery fall into the following broad categories:

- fuel, other **supplies and routine equipment servicing**, which are derived from the provincial price survey;
- **travel costs and training costs**, which are based on province and district-specific travel routes and local costs of accommodation and venue hire;

- **board fees and politicians' salaries and allowances**, which are based on determinations under the *Boards Fees and Allowances Act* and the Salaries and Remuneration Commission Determination of National Parliament, respectively;
- **road maintenance costs and maintenance costs of buildings**, which are based on Department of Works data

3.5 Estimated Costs for 2009

What are we counting in the Cost of Services Study?

The table below shows the estimated costs for all administration and service delivery sectors at the provincial and district levels in 2007. These exclude staffing costs and capital or projects costs.

Provincial and district costs

Table 1: Province and districts costs (excluding staffing costs)

Province	Health and HIV	Education	Infrastructure	Village Courts	Agriculture	Other Service Delivery Costs (b)	Administration costs (a)	Total
Central	3,023,535	3,945,285	8,583,944	95,422	1,221,701	2,342,432	1,352,242	20,564,560
East New Britain	3,149,425	4,191,969	6,542,220	51,181	1,336,901	2,650,288	2,522,711	20,444,695
East Sepik	6,209,010	4,196,747	13,354,469	102,914	1,686,520	2,785,928	3,188,342	31,523,929
Eastern Highlands	4,402,015	5,085,155	12,440,736	56,488	1,372,041	2,608,185	2,063,582	28,028,202
Enga	3,459,228	3,329,395	8,830,419	82,921	1,381,411	2,198,455	2,147,546	21,429,375
Gulf	2,441,565	2,002,124	3,474,254	28,731	920,438	1,441,431	1,443,209	11,751,753
Madang	4,870,684	3,137,998	7,980,733	31,792	1,594,993	2,881,329	2,365,698	22,863,227
Manus	1,260,485	1,552,845	3,061,529	49,316	549,540	1,351,690	1,811,798	9,637,202
Milne Bay	5,627,904	4,027,848	4,839,963	59,884	1,245,363	2,373,305	2,297,138	20,471,404
Morobe	6,273,827	6,954,711	11,577,686	59,993	2,475,859	3,873,308	3,328,540	34,543,924
New Ireland	2,901,235	2,339,477	3,421,019	28,012	714,557	1,996,461	2,006,345	13,407,107
Oro	2,425,987	1,896,720	2,595,942	33,371	805,773	1,646,769	1,715,130	11,119,693
Sandaun	4,858,369	3,838,466	4,490,094	54,522	1,721,661	1,712,429	2,365,425	19,040,966
Simbu	2,928,747	3,848,343	5,860,283	60,975	852,815	1,764,305	2,061,944	17,377,412
Southern Highlands	6,435,810	5,264,437	8,555,926	138,779	2,262,688	2,859,606	2,878,739	28,395,984
West New Britain	3,823,559	3,697,139	2,653,696	150,792	1,126,682	2,362,787	1,985,000	15,799,655
Western	5,579,852	4,393,595	10,145,625	102,816	1,624,431	2,416,267	2,628,996	26,891,581
Western Highlands	3,632,772	5,648,852	12,004,176	205,981	1,421,246	2,394,528	2,134,748	27,442,302
TOTAL	73,304,009	69,351,104	130,412,715	1,393,889	24,314,620	41,659,502	40,297,132	380,732,971

- (a) Assembly, Office of the Administrator, Internal Audit, Local-level Government administration, HRD Policy, Planning and Research, Finance and Administration and Legal Services
- (b) Commerce, Communication, Community Development, Correctional Services, Environment, Fisheries, HIV, Land Administration, Natural Resource Management, and Police

The three big sectors, Infrastructure, Health/HIV and Education, account for over 80 percent of the total service delivery costs at the provincial and district levels.

Individually, **Infrastructure** is the most expensive sector, making up over a third of total estimated costs. **Health/HIV** accounts for about 20% of total service delivery costs whilst **Education** costs is just under 19% of the total costs.

The cost of **infrastructure** is dominated by the cost of maintaining roads, bridges and jetties. The length of the road network in the country determines the overall cost in this sector. **Health** and **education** are expensive because they are delivered through a large network of facilities. Schools and health facilities are the main sectors which place public servants in rural areas, outside district administration headquarters, delivering services to communities. No other sector has anywhere near the same presence.

The other major sector, **agriculture**, which makes up just over 6% of total costs, mainly involves extension officers travelling into rural areas to provide extension services. As such, much of the cost in this sector is associated with public servant travel. While agriculture also involves contact with a large number of people, there are relatively fewer agricultural extension officers than there are teachers or health workers.

Note that three of the service delivery sectors are areas of national government responsibility: **police, correctional services** and **NBC**. These sectors have been included in the cost of provincial service delivery because in 1999 the National government imposed a requirement that provinces meet some of the costs associated with running these functions.

The law and order sectors (which include police, correctional services and magistrates' courts) are the only area of service delivery in which the national government controls most of the frontline service delivery staff.

'Assembly' is the administrative costs associated with the political structures of Provincial and Local-level Governments. The administrative aspect of assembly services accounts for two-thirds of the administrative overhead costs of Provincial and Local-level Governments. However, there is considerable variation among provinces.

The main reason for this is the cost of paying allowances to politicians, in particular Local-level Government politicians. The cost of politicians travelling to meetings also has a major impact on administration overheads, especially where politicians need to travel long distances to attend Assembly or Local-level Government meetings.

The main reason why assembly costs are so much higher in some provinces than in others is that they have **more politicians**.

Local-level Governments

Given the time and resources available at the time of undertaking the costing study, the NEFC only attempted to cost rural Local-level Governments. Table 2 shows the relevant costs associated with Local-level Governments under each sector. Note that in most sectors, there were no responsibilities which Local-level Governments were responsible to fund. The main sectors which Local-level Governments have responsibilities include Health/HIV, Education and Village Courts (refer to Appendix B).

The costing study found that there is far less similarity among provinces in terms of urban services than there is among rural services in different provinces. The nature of the services that need to be provided depends on the size of the urban population.

The nature of the services provided by different urban Local-level Governments around PNG varies considerably. For example, some of them are required to provide water and/or sewerage services, whereas in other towns one or both of these services are provided on a user-pays basis by the PNG Waterboard. In smaller towns residents provide these services to themselves, by collecting rainwater in tanks and using pit latrines or septic tanks. Some towns have extensive paved roads, while others have mainly dirt roads.

Table 2: Rural local government costs (excluding staffing costs) 2007

Province	Health and HIV	Education	Infra.	Village Courts	Agric.	Other Service Delivery Costs (b)	Admin. costs (a)	Total
Central	86,326	710,009	0	65,615	0	0	993,321	1,855,271
ENB	105,196	738,760	0	23,488	0	0	1,560,158	2,427,602
East Sepik	119,605	817,200	0	71,928	0	0	2,273,703	3,282,436
EHP	78,308	788,509	0	100,679	0	0	487,771	1,455,267
Enga	128,825	508,544	0	77,548	0	0	961,506	1,676,423
Gulf	87,922	184,291	0	22,598	0	0	879,698	1,174,508
Madang	158,488	452,350	0	49,173	0	0	2,056,190	2,716,200
Manus	65,002	215,500	0	27,867	0	0	231,080	539,449
Milne Bay	154,419	658,750	0	21,026	0	0	1,450,158	2,284,353
Morobe	222,367	1,125,428	0	58,735	0	0	2,372,578	3,779,108
New Ireland	40,180	400,816	0	26,077	0	0	502,028	969,101
Oro	71,719	279,272	0	11,848	0	0	979,078	1,341,916
Sandaun	162,656	416,250	0	16,826	0	0	3,081,118	3,676,850
Simbu	56,973	706,016	0	93,299	0	0	447,444	1,303,731
SHP	253,455	773,819	0	133,602	0	0	1,731,457	2,892,333
WNB	88,608	634,081	0	29,439	0	0	759,874	1,512,002
Western	113,230	468,925	0	34,379	0	0	2,115,515	2,732,049
WHP	152,250	958,025	0	84,627	0	0	622,652	1,817,554
Total	2,145,529	10,836,544	0	948,753	0	0	23,505,329	37,436,154

As Table 2 shows, apart from the administrative costs which are dominated by Assembly related costs, the only service delivery sectors which have Local-level Government funding responsibilities are Health, Education and Village Courts.

What year should costs be calculated with reference to the distribution year or 2nd preceding year?

The Cost of Services Study was conducted in 2005. Therefore, 2005 will be the base year for any updating of the costing data. That is, whatever factors are taken into consideration in updating the costing data will need to have 2005 as the base year.

Revenues, which form the other component of the fiscal needs calculation, will be based on the second preceding year's data, since those would be the latest actual figures available. Hence, for 2009, the latest available actual revenue data will be from 2007, which is the second preceding year from 2009.

Similarly, for costs, NEFC intends to apply the second preceding year's cost data to calculate fiscal needs of Provincial and Local-level Governments. For that reason, applying 2007 costs and revenues in the fiscal needs calculations would be more relevant and related to the same period of time.

Is it appropriate or realistic to update any of the data or prices from the Costs of Services Study?

It is planned that updating of the Cost of Services data should happen in five year intervals. Hence, the next Cost of Services Study will be conducted in 2010, with the work primarily focussed on updating the recurrent, non-salary goods and services costs.

Given the massive government allocation of K10 million each to all districts and other grants from the development budget, which include DSIP, DRIP, DSG, one would think that it would be very beneficial to update this costing data to reflect the perceived increase in the number of facilities and staffing levels.

Additionally, as is highlighted in Appendix D of this chapter, the costing data is only essential minimum costs from which to develop a basis for estimating minimum costs of service delivery. Hence it is imperative that this costing data be further developed to take into account some of the general assumptions made, which are also explained in some detail in Appendix D.

What indexation factors should be used to grow the costs?

The Cost of Services Study was undertaken in 2005, incorporating provincial specific costs of inputs for that year. Given its intensity and the resource requirements involved in this Study, it would be advisable to at least index these costing figures by some factors. This is so because the NEFC estimates that the difference in undertaking a whole cost of services study, compared to indexing the relevant input factors, especially of the prices of resources used in each of the functions and activities under each sector, would not bear too much of a difference.

Therefore, for the 2009 budget, NEFC took into account the growth factors in population and the Consumer Price Index for 2007. NEFC then used these indexed estimated costs for each province to derive the 'fiscal needs' of each Provincial Government.

4 ASSESSED REVENUES

4.1 Introduction

Under the new funding arrangements, calculation of grants for the Provincial and Local-level Governments is based on the need of each province. This is the difference between the revenues and costs of assigned service delivery functions and responsibilities. For this reason, revenues for Provincial Governments need to be calculated in order to be assessed.

Assessed revenues are the amount of revenues which are likely to be received by the Provincial Government for the fiscal year and which is expected to be used for the performance of its assigned service delivery functions.

To assess revenues for the Provincial Governments, it is important to establish the sorts of revenues that each Provincial Government collects.

4.2 Source of Revenue Data

Revenue data is compiled from multiple sources. All reasonable effort is taken to obtain data from the most reliable and consistent information sources.

These are:

National goods and services grants

The National Government provides Provincial Governments with a range of goods and services grants each year to support a variety of core service delivery activities.

This information is sourced from data on actual grants paid, reported in National Budget Papers.

GST

Provincial Governments receive a Goods and Services Tax (GST) distribution paid through the Internal Revenue Commission (IRC). This data is sourced from the IRC.

Own-source revenue

Provincial Governments collect revenue from a variety of activities including licenses, fees, taxes and commercial activities.

This data is obtained from the PNG Government Accounting System (PGAS) “internal revenue” electronic summary files held by the Department of Finance (DoF).

Mining and Petroleum Royalties

Provincial Governments with mining and petroleum activities within their provincial boundaries may be entitled to royalties as a result of Memoranda of Agreement (MOA) between the Provincial Government, customary land owners, the mining company and other stakeholders. In the case of petroleum projects negotiated after 1988, Provincial Governments shares are provided under the provisions of the relevant mining and petroleum legislation.

This data has been sourced direct from mining and petroleum companies and from Government agencies (Mineral Resources Authority (MRA) for mining projects, and Department of Petroleum and Energy (DPE) for petroleum projects).

Mining and Petroleum Dividends

Provincial Governments with mining and petroleum activities within their provincial boundaries may also be entitled to dividends through MOA between the Provincial Government, customary land owners, the mining company and other stakeholders.

This data is sourced from the Mineral Resources Development Corporation (MRDC) and direct from relevant mining and petroleum companies (where available).

4.3 Types of revenue

Apart from the national grants, the following sources of revenues are used to assess revenues available to Provincial Governments:

- own source revenues;
- royalties and dividends from Mining and petroleum projects;
- GST distributions, under the proposed *Intergovernmental Relations (Functions and Funding) Act 2008*;
- bookmakers Tax, distributed under the proposed *Intergovernmental Relations (Functions and Funding) Act 2008*; and
- any other fiscal benefits.

Generally, revenues for a fiscal year are assessed with reference to the second preceding year to that fiscal year as this will be the last available year of data. That is, for the 2009 distribution year, 2007 revenues were assessed by the NEFC.

4.4 How are the different revenues assessed?

Own Source Revenue

These are local taxes, charges, and receipts collected by the provincial administration, which are the only revenue base that provinces have some local control and influence over. These comprise of;

- motor vehicle registration and license fees
- land taxes
- liquor license fees
- gambling taxes
- bookmakers' turnover tax
- returns on investments

- proceeds from business activities, rents, sale of assets
- court fees & fines; and
- other fees & charges

The NEFC estimates that in 2007, provinces raised about K51.6 million from this revenue source.

Table 3: Own Source Revenues (K'000) – 2007

West. Province	85.8
Gulf	1,697.6
Central	3,268.4
N.C. D.	10,187.3
Milne Bay	926.6
Oro	270.9
South. Highlands	1,080.1
Enga	5,686.6
West. Highlands	2,083.0
Simbu	431.6
East. Highlands	1,577.0
Morobe	5,793.2
Madang	1,178.2
East Sepik	2,081.8
Sandaun	1,881.9
Manus	381.6
New Ireland	750.6
East New Britain	2,852.7
West New Britain	4,899.0
Bougainville	4,511.6
TOTAL	51,625.4

Royalties and Dividends from Mining/Petroleum projects

For every new project since the late 1980s, the National Government has not exercised claims over mining and petroleum royalties in the MOAs. Instead, the royalties have been split among landowners, Local and Provincial Governments, in various ways depending on the project. In turn, Provincial Governments have also sometimes made various long-term commitments regarding their share of royalties (for specific projects, to local governments and/or non-government agents).

In 2007, NEFC estimates that provinces received about K142.0 million from these sharing arrangements as contained in the MOAs.

Table 4: Mining and Petroleum Payments (K'000) – 2007

Province	Royalties	Dividends	Total
West. Province	44,900.0	34,600.0	79,500.0
Gulf	-	4,840.6	4,840.6
Central	342.8	-	342.8
N.C. D.	-	-	0.0
Milne Bay	-	-	0.0
Oro	-	-	0.0
South. Highlands	27,019.6	5,753.6	32,773.2
Enga	10,476.7	1,111.1	11,587.8
West. Highlands	-	-	0.0
Simbu	-	-	0.0
East. Highlands	53.1	-	53.1
Morobe	-	-	0.0
Madang	-	-	0.0
East Sepik	-	-	0.0
Sandaun	-	-	0.0
Manus	-	-	0.0
New Ireland	12,921.2	-	12,921.2
East New Britain	-	-	0.0
West New Britain	-	-	0.0
Bougainville	-	-	0.0
TOTAL	95,713.5	46,305.3	142,018.8

GST distribution

GST is collected and administered by the IRC. The IRC distributes a portion of the GST revenue to Provincial Governments and the NCD as set out in the *GST Revenue Distribution Act 2003* (the distribution Act). This Act has now been repealed and the provisions relocated to the proposed *Intergovernmental Relations (Functions and Funding) Act*. Any remaining GST that is not distributed to Provincial Governments or the NCD under these sharing arrangements is paid into consolidated revenue (to the National Government).³

The amount of GST distributed under the proposed Act will be based on 60% of net inland GST collections for each province from the second preceding year.

Generally, revenues for a fiscal year are to be assessed with reference to the second preceding year to that fiscal year as this will be the last available year of data. For the 2009 distribution year, 2007 revenues would be assessed by the NEFC. So GST distribution will be based on 60% of net inland GST collected from the second preceding year (ie. 2007).

³ It is important to note that these distribution arrangements to Provincial Governments are not shown in the national budget. The amounts of GST shown in the national budget are the amounts retained by the National Government, after Provincial Governments and the NCD have received their distribution.

Table 5. GST Distribution 2007

PROVINCE	GST Distribution
	(K'000)
Central	1,047.3
East New Britain	6,547.8
East Sepik	2,441.4
Eastern Highlands	8,319.8
Enga	755.6
Gulf	542.5
Madang	8,444.7
Manus	343.9
Milne Bay	2,498.5
Morobe	33,019.5
New Ireland	2,452.8
Oro	1,099.9
Sandaun	585.6
Simbu	1,123.0
Southern Highlands	1,232.9
West New Britain	3,732.5
Western	2,908.3
Western Highlands	11,454.9

Bookmakers Tax

Bookmakers Tax received by Provincial Governments will be 100% of the revenues collected in the province in the second preceding year.

Table 6: Distribution of Bookmakers Tax 2007

PROVINCE	Bookmakers (K'000)
Central	0
East New Britain	329.61
East Sepik	42.68
Eastern Highlands	237.51
Enga	0
Gulf	0
Madang	625.47
Manus	0
Milne Bay	0
Morobe	810.12
New Ireland	83.68
Oro	0
Sandaun	0
Simbu	0
Southern Highlands	0
West New Britain	0
Western	0
Western Highlands	401.14
Total	2,530.21

4.5 2009 assessed revenues

For the purpose of calculating the different funding levels of the different function grants in 2009 onwards, the following assessments have been made. All revenues are assessed based on the actual revenues collected for the second preceding year for each province.

i) Royalties and Dividends from Mining and Petroleum Project

- 80% of *royalties and dividends from mining and petroleum projects* (except for dividends received from 'paid equity' held in mining and petroleum projects, which is assessed at 50% e.g. Southern Highlands & Gulf investments in Kutubu project); this gives the recognition that some revenues are spent on development of mining infrastructure.

ii) Own Source Revenues

- 50% of *own source revenues* collected.

iii) GST

- 100% of *GST* distributed under the proposed *Intergovernmental Relations (Functions and Funding) Act 2008* (which is 60% of net inland collections).

iv) Bookmakers Turnover Tax

- 100% of *Bookmakers Tax* distributed under the proposed *Intergovernmental Relations (Functions and Funding) Act 2008*.

Table 7: 2009 Assessed Revenues (K'000)

	2008 Individual Transitional Province Guarantees	GST Distribution	Bookmakers Tax	Own Source Revenues	Royalties	Dividends	Total
Assess Percentage	100%	100%	100%	50%	80%	50%	
West. Province	4,199.0	2,908.3	-	42.9	35,920.0	17,300.0	60,370.2
Gulf	3,424.4	542.5	-	848.8	-	2,420.3	7,236.0
Central	3,878.5	1,047.3	-	1,634.2	274.3	-	6,834.3
Milne Bay	3,913.7	2,498.5	-	463.3	-	-	6,875.5
Oro	3,309.2	1,099.9	-	135.4	-	-	4,544.5
South. Highlands	7,382.5	1,232.9	-	540.0	21,615.7	2,876.8	33,647.9
Enga	6,627.3	755.6	-	2,843.3	8,381.4	555.6	19,163.2
West. Highlands	7,203.8	11,454.9	401.1	1,041.5	-	-	20,101.3
Simbu	4,280.2	1,123.0	-	165.0	-	-	5,568.2
East. Highlands	8,380.5	8,319.8	237.5	788.5	42.5	-	17,768.8
Morobe	7,717.2	33,019.5	810.1	2,896.6	-	-	44,443.4
Madang	8,049.8	8,444.7	625.5	589.1	-	-	17,709.1
East Sepik	6,727.4	2,441.4	42.7	1,040.9	-	-	10,252.4
Sandaun	4,149.2	585.6	-	940.9	-	-	5,675.7
Manus	2,246.0	343.9	-	190.8	-	-	2,780.7
New Ireland	3,697.8	2,452.8	83.7	375.3	10,337.0	-	16,946.5
East New Britain	7,839.3	6,547.8	329.6	1,426.3	-	-	16,143.1
West New Britain	7,846.3	3,732.5	-	2,449.5	-	-	14,028.3
Total	100,872.2	88,550.8	2,530.2	18,412.5	76,570.8	23,152.7	310,089.0

4.6 Fiscal Needs of Provincial and Local-Level Governments

4.7

The fiscal needs of a Provincial and Local-level Government is the difference between the cost of providing the assigned service delivery functions and responsibilities and the revenue available to the Provincial and Local-level Governments to pay for these services.

Where a Provincial and Local-level Government has assessed revenues that are greater than its costs, its fiscal need is zero.

5 FISCAL NEEDS AMOUNTS FOR PROVINCIAL AND LOCAL LEVEL GOVERNMENTS

The amount that a Provincial and Local-level Government needs is called the ***fiscal needs amount***. This amount is calculated on the basis of the recurrent cost of providing the assigned service delivery functions and responsibilities, as well as the revenue already available to the Provincial and Local-level Governments to pay for these services.

5.1 FISCAL NEEDS AMOUNTS FOR PROVINCIAL GOVERNMENTS

The fiscal needs amount for a Provincial Government is calculated using the formula:

$$\begin{array}{l} \text{Estimated recurrent cost of} \\ \text{assigned service delivery} \\ \text{functions \& responsibilities} \end{array} - \begin{array}{l} \text{Assessed} \\ \text{revenue} \end{array} = \begin{array}{l} \text{Fiscal Needs} \\ \text{amounts} \end{array}$$

where:-

“*estimated recurrent cost of assigned service delivery functions and responsibilities*” are the estimated recurrent cost for the Provincial Government of performing its assigned service delivery functions and responsibilities for the fiscal year, including the necessary and incidental costs of administration of the Provincial Government;

“*assessed revenue*” is the amount of revenue that the NEFC considers to be available to the Provincial Government for meeting the recurrent cost of its assigned service delivery functions and responsibilities for the fiscal year.

5.2 FISCAL NEEDS AMOUNTS FOR LOCAL LEVEL GOVERNMENTS

The fiscal needs amount of each Local-level Government for each fiscal year is calculated using the formula -

$$\begin{array}{l} \text{Estimated recurrent cost of} \\ \text{assigned service delivery} \\ \text{functions \& responsibilities} \end{array} - \begin{array}{l} \text{Assessed} \\ \text{revenue} \end{array} = \begin{array}{l} \text{Fiscal Needs} \\ \text{amounts} \end{array}$$

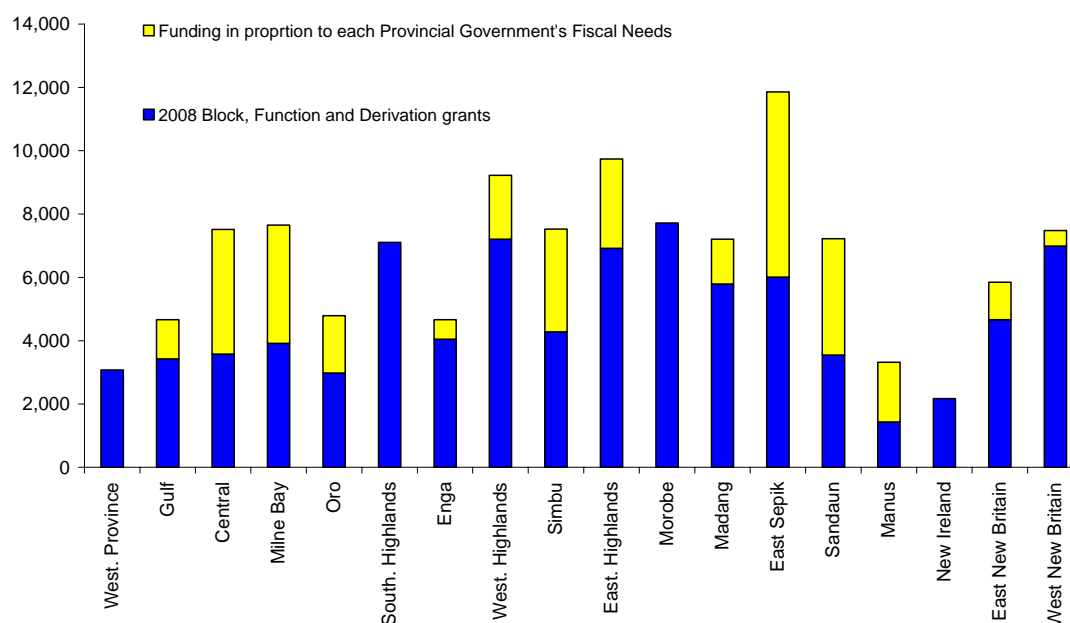
Where:-

“*estimated recurrent cost of assigned service delivery functions and responsibilities*” are the recurrent cost to the Local-level Government of performing its assigned service delivery functions and responsibilities for the fiscal year, including the necessary and incidental costs of administration of the Local-level Government;

“*assessed revenue*” is the amount of revenue that the NEFC considers to be available to the Local-level Government for meeting the recurrent cost of its assigned service delivery functions and responsibilities for the fiscal year.

Table 8: Fiscal Needs of Provinces (K'000)

	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
West. Province	26,892	60,370	0	0.0%
Gulf	11,752	7,236	4,516	3.7%
Central	21,159	6,834	14,325	11.6%
Milne Bay	20,471	6,875	13,596	11.0%
Oro	11,120	4,545	6,575	5.3%
South. Highlands	28,396	33,648	0	0.0%
Enga	21,429	19,163	2,266	1.8%
West. Highlands	27,442	20,101	7,341	5.9%
Simbu	17,377	5,568	11,809	9.6%
East. Highlands	28,028	17,769	10,259	8.3%
Morobe	34,544	44,443	0	0.0%
Madang	22,863	17,709	5,154	4.2%
East Sepik	31,524	10,252	21,272	17.2%
Sandaun	19,041	5,676	13,365	10.8%
Manus	9,637	2,781	6,856	5.6%
New Ireland	13,407	16,947	0	0.0%
East New Britain	20,445	16,143	4,302	3.5%
West New Britain	15,800	14,028	1,771	1.4%
TOTAL	381,328	310,089	123,408	100.0%



6 INDIVIDUAL PROVINCE SHARE

Provincial Governments are all different, therefore they will each need a different amount to deliver their assigned service delivery functions and responsibilities.

The individual province share is the amount an individual Provincial Government receives from the equalisation system. This amount is divided into service delivery function grants and an administration grant.

During the transition period the individual province share is calculated using the formula:

$$\text{transitional individual province guarantee} + \left(\text{equalisation amount for provinces} \times \frac{\text{fiscal needs amount of individual province}}{\text{total fiscal needs amount of provinces}} \right) = \text{individual province share}$$

where -

“transitional individual province guarantee” means the transitional individual province guarantee of that Provincial Government for the relevant fiscal year;

“equalisation amount for provinces” means the amount equal to the province share specified in the determination made under paragraph 2(1)(c) that is in force on 30 April of the immediately preceding fiscal year;

“fiscal needs amount of individual province” means the fiscal needs amount of that Provincial Government for the relevant fiscal year;

“total fiscal needs amount of provinces” means the total of the fiscal needs amounts of the Provincial Governments that have fiscal needs amounts greater than zero for the relevant fiscal year.

Table 9: 2009 Individual Province Share (K'000)

West. Province	4,199.0
Gulf	4,665.7
Central	7,816.2
Milne Bay	7,651.0
Oro	5,116.6
South. Highlands	7,382.5
Enga	7,250.3
West. Highlands	9,221.7
Simbu	7,526.4
East. Highlands	11,200.7
Morobe	7,717.2
Madang	9,466.6
East Sepik	12,574.7
Sandaun	7,823.1
Manus	4,130.7
New Ireland	3,697.8
East New Britain	9,021.8
West New Britain	8,333.2
TOTAL	134,795.4

7 INDIVIDUAL LOCAL-LEVEL SHARE

The individual rural Local-level share is the amount an individual rural Local-level Government receives from the equalisation system.

The Local-level Government share is divided into two amounts: one for urban Local-level Governments, and an amount for rural Local-level Governments. These are called individual local-level shares.

The amounts for individual urban or rural Local-level Government for the relevant fiscal year is calculated using the formula:

$$\text{transitional individual local-level guarantee} + \left(\text{equalisation amount for urban Local-level Governments} \times \frac{\text{fiscal needs amount of individual urban Local-level Government}}{\text{total fiscal needs amount of urban Local-level Governments}} \right) = \text{individual local-level share}$$

where—

“transitional individual local-level guarantee” means the transitional individual local-level guarantee of that urban Local-level Government for the relevant fiscal year;

“equalisation amount for urban Local-level Governments” means the amount estimated by the NEFC to be the urban Local-level Governments’ share of the local-level share specified in the determination made under paragraph 2(1)(d) that is in force on 30 April of the immediately preceding fiscal year;

“fiscal needs amount of individual urban Local-level Government” means the fiscal needs amount of that urban Local-level Government for the relevant fiscal year;

“total fiscal needs amount of urban Local-level Governments” means the total of the fiscal needs amounts of the urban Local-level Governments that have fiscal needs amounts greater than zero for the relevant fiscal year.

A similar formula is used to calculate the rural Local-level Government share.

Most rural Local-level Governments have minimal revenues available to them. However, they each have very different costs. Reasons include higher costs due to remoteness or having different populations to service. Even though most rural Local-level Governments have little or no revenue, Local-level Governments have different fiscal needs amounts because they all have different costs.

Urban and rural Local-level Governments have different assigned service delivery functions and responsibilities. They also have different revenues available to them. Urban Local-level Governments can raise substantially more revenue to fund a more significant proportion of their service delivery costs. Rural Local-level Governments tend to have minimal revenues and fewer service delivery functions and responsibilities.

Revenues for rural and urban Local-level Governments have been assessed at zero. This is because data on these revenues are incomplete and of poor quality. However, eventually the NEFC expects to obtain better information on the revenues of urban Local-level Governments and would then assess these more accurately. It may never be possible to accurately assess revenues for over 308 rural Local-level Governments. In the circumstances, revenues for rural Local-level Governments may remain at zero.

Table 10: Individual Rural Local-Level Government Share (K'000)

Province	Individual Urban LLG grants	Individual Rural LLG grants	TOTAL
Western	583.9	1,382.9	1,966.8
Gulf	122.8	891.8	1,014.7
Central	0.0	1,450.3	1,450.3
Milne Bay	237.0	1,613.5	1,850.5
Oro	475.9	930.2	1,406.1
Southern Highlands	753.2	3,708.4	4,461.6
Enga	100.8	2,076.0	2,176.8
Western Highlands	668.0	2,871.3	3,539.3
Simbu	222.0	1,750.3	1,972.3
Eastern Highlands	630.5	2,829.2	3,459.6
Morobe	2,259.4	3,373.5	5,632.9
Madang	684.1	2,552.9	3,237.0
East Sepik	485.4	2,579.5	3,064.9
Sandaun	234.1	1,692.3	1,926.4
Manus	140.8	330.4	471.3
New Ireland	270.0	816.4	1,086.4
East New Britain	579.0	1,607.1	2,186.1
West New Britain	339.9	1,289.4	1,629.3
Total	8,786.7	33,745.5	42,532.2

On average, Local-level Governments have experienced a 13% increase in funding each year from 2004 to 2007 and will receive a further 9% increase in the 2009 budget from their 2008 levels.

The total Local-level Government share is divided between rural and urban Local-level Governments in the same proportion as provided in the 2008 budget i.e. 79% rural, 21% urban.

The rural Local-level Government share is then further divided into 308 individual Local-level Government amounts, based on district costs and population in each Local-level Government.

For urban Local level governments, their funding is determined as what they received in 2008 PLUS their share of additional funding for urban on a population basis.

8 FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

8.1 The Function and Administration Grants Determination

As stated earlier in the report, the equalisation amount is broken down amongst the different service delivery function grants for each Provincial Government based on the fiscal need of the relevant service sector (such as health and transport infrastructure maintenance) through comparing the NEFC's estimated cost of service delivery for each sector against the funding level for each sector.

Provincial Administrations were provided these amounts through the 2009 Budget Circular and provided their 2009 Budgets submissions, generally within these ceilings. As part of the process, provinces were allowed to request a shift among function grants within their overall provincial ceiling.

Treasury had negotiations with provinces that requested changes and agreement was reached as to the revised split among the function grants.

The Determination was then prepared and signed by the Treasurer in September 2008 to formalize the splits amongst the provincial grants for the 2009 Budget (refer Appendix B).

This was signed and issued prior to the meeting of the Budget Screening Committee with the provinces in order that they can focus their discussions on personnel emoluments and the development budget.

The table below shows the final amounts (in K'000) for each service delivery function grant for each province for 2009.

2009 Function and Administration Grants Determination

	Health Function Grant	Education Function Grant	Transport Infrastructure Maintenance Function Grant	Village Courts Function Grant	Agriculture Function Grant Ceiling	Other Service Delivery Function	Administration Grant	Total Provincial Government Grants
Western	875.5	892.5	1,403.4	127.6	618.1	141.0	141.0	4,199.0
Gulf	1,128.4	1,383.2	754.3	49.0	532.8	471.1	347.0	4,665.7
Central	1,561.0	2,090.9	2,095.7	153.9	257.6	1,252.3	404.8	7,816.2
Milne Bay	1,876.9	1,715.2	1,690.3	76.2	556.0	1,017.7	718.7	7,651.0
Oro	1,120.1	1,109.8	1,187.8	42.5	773.4	441.5	441.5	5,116.6
Southern Highlands	2,048.2	1,839.5	1,419.4	257.3	46.7	916.5	855.0	7,382.5
Enga	1,829.4	929.3	2,637.2	153.3	89.2	1,126.6	485.3	7,250.3
Western Highlands	1,773.0	2,402.0	2,459.4	274.3	1,199.7	613.4	500.0	9,221.7
Simbu	1,370.0	2,065.7	1,884.3	150.2	144.6	1,199.2	712.3	7,526.4
Eastern Highlands	2,280.9	2,956.7	2,556.5	153.0	1,025.5	1,328.1	900.0	11,200.7
Morobe	722.3	1,644.0	3,043.3	113.7	373.4	910.3	910.3	7,717.2
Madang	2,056.0	1,967.8	2,459.4	78.3	760.2	1,440.3	704.8	9,466.6
East Sepik	2,977.5	2,898.9	3,405.7	167.3	850.6	1,301.4	973.2	12,574.7
Sandaun	1,882.6	1,809.9	1,812.8	67.1	382.1	1,091.0	777.7	7,823.1
Manus	911.4	876.7	1,207.7	73.3	101.5	707.4	252.8	4,130.7
New Ireland	863.6	845.0	1,020.8	51.7	547.3	184.7	184.7	3,697.8
East New Britain	1,930.7	2,663.0	2,232.5	70.6	1,527.3	516.6	81.1	9,021.8
West New Britain	1,238.2	1,544.2	771.7	165.3	4,330.6	155.1	128.2	8,333.2
TOTAL	28,445.8	31,634.3	34,042.0	2,224.6	14,116.6	14,814.0	9,518.1	134,795.4

8.2 Service Delivery Function Grants

- (i) Service Delivery Function Grants are provided to Provincial Governments to ensure that a minimum set of core services are adequately funded so as to benefit the majority of people across Papua New Guinea.
- (ii) Service Delivery Function Grants are to be used exclusively for goods and services (operational costs) and not to fund salaries, capital or development costs unless specified in the budget.

Types of Service Delivery Function Grants and Administration Grants 2009

- (iii) The following service delivery function grants will be in operation in 2009 (though they may increase in number in the future):
 - Education Service Delivery Function Grant
 - Health Service Delivery Function Grant
 - Transport Infrastructure Maintenance Grant
 - Village Courts Function Grant (Operations)
 - Agriculture Service Delivery Function Grant
 - Other service delivery function grant

8.3 Administration Grant

- (iv) This grant is to fund general overhead costs or meeting the day to day operation costs of the Provincial Administration.
- (v) No salaries or other personal emoluments, casual wages, and debt payment are to be paid using the administration grant.

8.4 Funding Minimum Priority Activities for Service Delivery Function Grants.

- (vi) A limited number of activities have been identified as absolute priorities across these five key function grant categories of Agriculture, Education, Health, Transport Infrastructure and Village Courts (all MTDS priority areas)
- (vii) The selection of Minimum Priority Activities (MPA) is designed to assist Provincial Governments to achieve more effective and targeted service delivery outcomes at the district and rural level.
- (viii) It is intended for Provincial Governments to create separate activity codes for each MPA in their respective budgets.
- (ix) Following consultation with the Provincial Governments, the following MPAs were endorsed by the Inter-Departmental Committee (IDC) and issued by the Secretary of Treasury in the Budget and Expenditure Instructions for use by all Provincial Governments in the 2009 budget;

Agriculture

- Extension activities for agriculture, fisheries and forestry

Education

- Distribution of school materials
- Supervision of schools by district and provincial officers
- Operation of district education offices

Health

- Operation of rural health facilities
- Integrated health patrols
- Drug distribution

Transport Infrastructure Maintenance

- Road and bridges maintenance
- Airstrip maintenance
- For maritime provinces- wharves and jetties maintenance

Village Courts Operations

Operational materials (eg. Flags, uniforms, badges) & supervision

8.5 Conditions of Funding and Expeniture Management of Service Delivery Function Grants and Administration Grant

- (x) Conditions for function grants (including the minimum priority activities) and management of expenditure are provided for in the Function and Administration Grant Determination and the “Budget and Expenditure Instructions” issued by the Secretary for Treasury.
- (xi) The Budget and Expenditure Instructions specify:
 - What grants, receipts or other revenues are to be used for and the expected outputs from spending
 - The management of grants, receipts or other revenues
 - How the expenditure of grants, receipts or other revenue is reported; and
 - The budget preparation process, including consultation with stake holders.
- (xii) The Department of Treasury, in conjunction with the Department of Provincial and Local Government and the National Economic and Fiscal Commission will seek to ensure compliance of these Budget and Expenditure Instructions.

9 MONITORING AND REPORTING ON EXPENDITURE

Section 65 of the proposed *Intergovernmental Relations (Functions and Funding) Act 2008* serves as the basis on which the Secretary for the Department of Treasury may, in consultation with the National Economic and Fiscal Commission, determine the conditions to which all or any of the following grants are subject;

- a) service delivery function grants
- b) administration grants
- c) rural local-level government grants
- d) urban local-level government grants
- e) staffing grants
- f) payments to address development needs

The Secretary for the Department of Treasury may issue Budget and Expenditure Instructions re-emphasizing conditions surrounding management and reporting aspects on the expenditure of the abovementioned grants.

The Department of Treasury, in conjunction with PLLSMA and NEFC, shall undertake regular quarterly expenditure reviews ensuring that conditions of implementation of the grants are observed and complied with.

The findings of these reviews shall be included in an annual Fiscal Report published by the NEFC.

The NEFC may provide to the Minister responsible for Finance and Treasury such information in relation to its findings requiring his attention.

The Budget and Expenditure Instructions should contain specific instructions as stipulated in s.65 of the *Intergovernmental Relations (Function and Funding) Act 2008*:

- a) what the grants are to be used for
- b) timing and nature of expenditure of grants
- c) expected outputs
- d) management of grants
- e) the nature, timing and format of information to others
- f) the budget preparation process (including stakeholder consultation).

It is anticipated that the 2009 Budget and Expenditure Instructions issued by the Secretary for Treasury shall contain specific guidance and conditions in the following areas:

- 1) the conditions relevant to service delivery function grants and administration grant.
- 2) key restrictions on the usage of service delivery function grants and administration grant.
- 3) list of service delivery function grants and administration grant for 2009
 - Education Function Grant
 - Health Function Grant
 - Transport Infrastructure Maintenance Grant
 - Village Courts Function Grant
 - Agriculture Function Grant
 - Other Service Delivery Function Grant
 - Administration Grant

- 4) correct usage of PGAS Grant Code for 2009 Function Grants
- 5) specification of Minimum Priority Activities
 - Agriculture
 1. Extension activities for agriculture ,fisheries and forestry
 - Education
 2. Distribution of school materials
 3. Supervision of schools by districts and provincial officers
 4. Operation of district education offices
 - Health
 5. Operation of rural health facilities
 6. Integrated health patrols
 7. Drug distribution
 - Transport Infrastructure Maintenance
 8. Roads and bridges maintenance
 9. Airstrip maintenance
 10. Wharves and jetties (for maritime provinces)
 - Village Courts
 11. Operational costs of village courts
- 6) Restrictions on rollovers of service delivery function grants and administration grant from 2008 to 2009
- 7) Reporting requirements for service delivery function grants and the administration grant.
- 8) Penalties for non-compliance.

10 PROVINCIAL EXPENDITURE REVIEW – 2006

The National Economic and Fiscal Commission has reviewed provincial expenditures for the fiscal years 2005 and 2006. The Provincial Expenditure Reviews (PER) are intended to review and report on the spending performance across the provinces on an annual basis. The 2006 PER was part of the ongoing process of reporting and comparing emerging trends in provincial expenditure patterns among provinces and across years.

These PERs are being conducted in order to enable reflection on what has happened and to identify what needs to change so that changes can be made that will improve service delivery.

We must reflect, and consider where and how we can improve. If we don't learn from the past we are likely to repeat the same practices again and again. And the services that we need to provide to our people across Papua New Guinea will remain dreams and not reality.

Ultimately everyone is interested in improved service outcomes. These include improved health care and a healthier population, improved schooling and educational attainment for children, a road network that is maintained and that enables the flow of people and goods for market, and a developing agricultural sector that provides income for the many. However, these are the outcomes of a range of activities: regular health patrols to rural areas; aid posts that function and are stocked with medical supplies; schools that are maintained and have basic materials and school books; roads that are regularly maintained and not left to degrade; and extension patrols that support agriculture development. These and many other similar activities that support and enable the delivery of services are the responsibility of Provincial Governments with significant funding provided by the National Government.

All these activities need money for the activities to happen. Fuel is needed for transport, medical supplies need distributing, school materials need to be purchased – everything has a cost. These costs are commonly referred to as 'recurrent goods and services'. Without funding for goods and services to support these activities, the improved health, education, transport and income generation outcomes will not occur. These costs must be adequately budgeted for and the money then applied for that purpose. Quite simply, if the activity is not funded, the activity is not being undertaken.

What the PERs have shown is that the pot of money that is made available for these activities is decreasing while the range of activities that is expected to be supported are increasing. Money that should be allocated to recurrent goods and services is often consumed in staff costs and development activities. But additional staff means that even more recurrent funds are required to effectively support their activities; and increased 'development' (or capital costs) often means additional recurrent funding is then required to support and maintain the new school, road or health clinic.

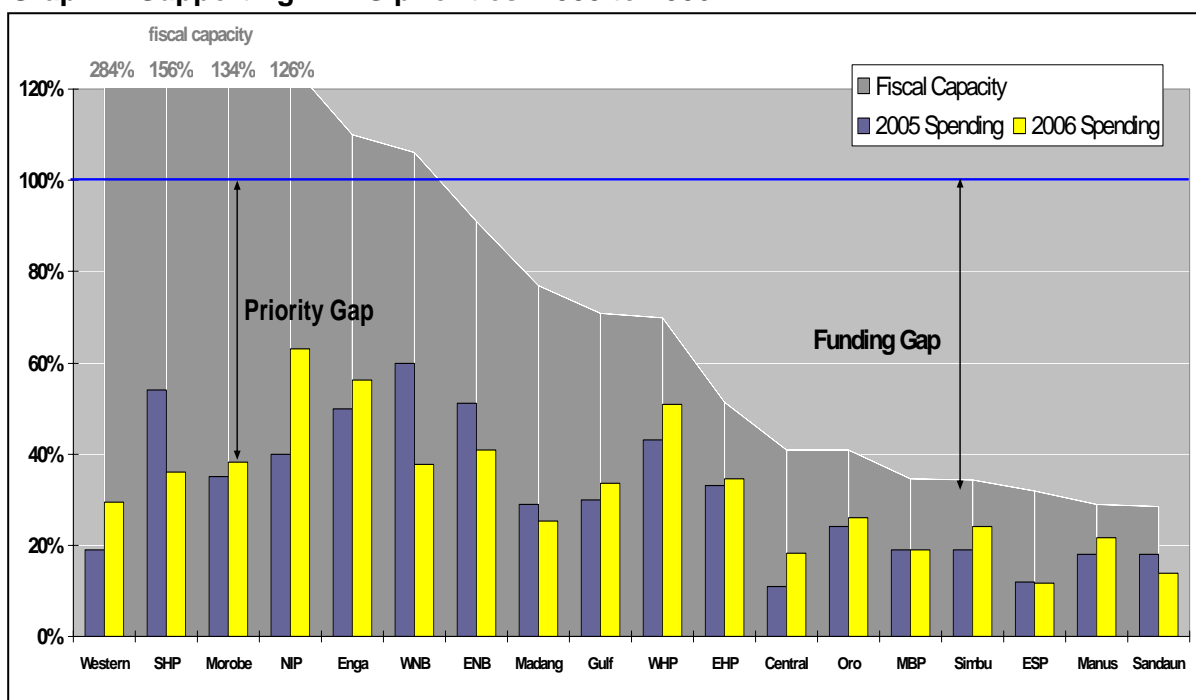
The 2005 PER sought to answer these three main questions in a systematic way using an evidence-based approach:

COST	How much does it cost to deliver priority services in each Province?
CAPACITY	What is the impact of each Province's resource envelope? (that is all funding including national grants and a proportion of internal revenue)
PERFORMANCE	Does provincial spending support service delivery?

The 2006 PER builds on this analytical work and by reviewing the data in the same manner enabled the NEFC to consider the emerging trends. The findings of these reviews are the first test as to how close the objective of delivering improved priority services are to being achieved.

Graph 1 draws together all provincial spending on MTDS priorities and compares this with the cost of fully funding the MTDS priorities. The graph demonstrates the twin hurdles that are faced in improving the delivery of services throughout the provinces. The first is a matter of provincial choice (that is, something provinces individually have the power to change by more effectively allocating money to core priorities within their Province) – this is called the priority gap. The second is a matter of funding, many provinces simply do not have sufficient funding – this is called the funding gap.

Graph 1: Supporting MTDS priorities: 2005 to 2006



The funding gap for most provinces continued in 2006 and will only be addressed by implementing the intergovernmental financing reform (commencing in 2009) that directs more resources to the provinces that do not have enough of their own resources to meet the cost of delivering core services to their people.

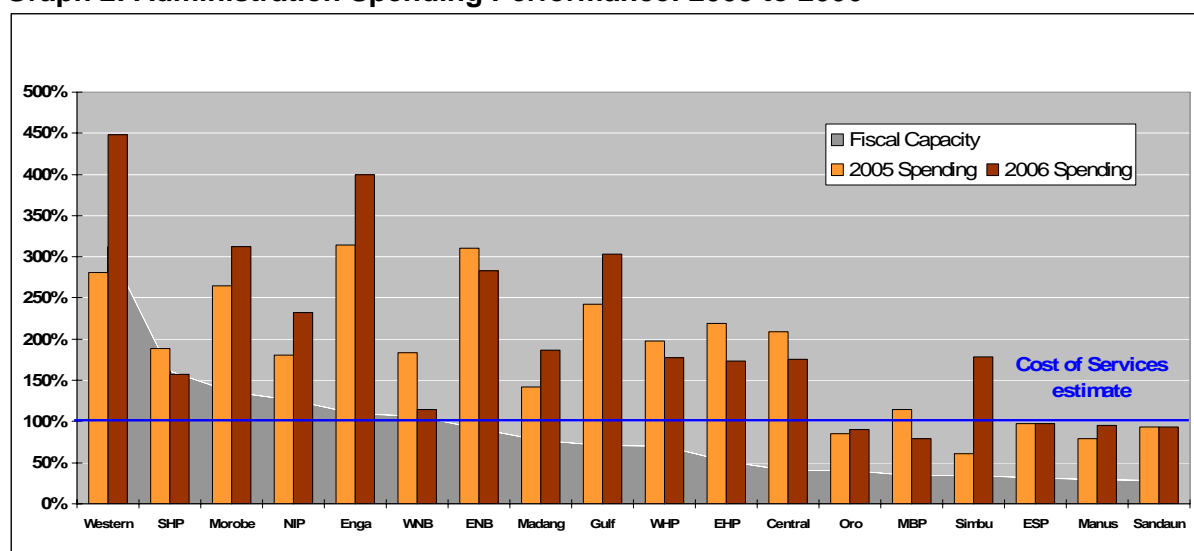
All Provincial Governments and Administrations need to address the priority gap by choosing to reallocate their own spending to support the priority sectors.

The impact of new infrastructure development needs to be considered. Every new infrastructure development creates ongoing costs. Effectively, new infrastructure development that is not matched with an increased recurrent budget will reduce service delivery. For example when a new school is built the recurrent budget needs to be increased to support this school year after year to pay for costs like materials and maintenance. If increased recurrent funding is not provided, funding is effectively taken away from existing schools to cover the new school. The more this is done the worse it gets for all schools.

The impact of employing more staff also needs to be considered. Increasing staff numbers places more demand on the recurrent goods and services budget. Effectively increasing staff numbers that are not matched with an increased recurrent budget will reduce service delivery. When additional staff are employed, they need to be resourced so they can do their jobs such as extension work and health patrols. They need office space, use electricity, often need a computer, need to travel for work (which means travel allowance, fuel costs, car hire, air travel etc) and require recreation leave fares. When recurrent budget is not increased to provide for these costs these effectively reduces the amount available to support all staff – and thereby reduces their effectiveness. For example that means less patrols to vaccinate children from preventable diseases and less extension work to farmers to help improve food security and improve income generation opportunities in rural communities.

Graph 2 illustrates the 2005 and 2006 performance of each province in the Administration sector using the Cost of Services estimate as a benchmark. It can be observed that every province prioritises Administration spending over spending on the MTDS priority sectors.

Graph 2: Administration Spending Performance: 2005 to 2006



In overall terms, total spending on health and education decreased by approximately K4 million between 2005 and 2006. How can service delivery be expected to be improved in these critical areas when spending is reduced, even though, like everything in life, the costs keep increasing each year? The reality is that at present, these services are deteriorating.

However, in overall terms spending on administration grew by nearly K8 million between 2005 and 2006. Spending in low priority areas need to be controlled and reduced. These include administration, projects, and casual wages.

In 2006 two-thirds of internal revenue expenditure went on non-priority areas such as administration, arrears, and smaller sectors. As much as possible, the provincial resource envelope (both national Government grant funds and internal revenue) should be used to support recurrent spending in priority areas of health, education and infrastructure maintenance.

NEFC analysis shows that often secondary education receives more funding than basic education. This means that many children are missing out on the opportunity to have basic education - learning how to read and write and other basic skills. It is necessary to ensure that elementary, community and primary schools (where 90% of enrolled children attend school) are adequately resourced.

What systems are in place to manage teacher leave fares and village court allowances? Spending in this area increased by 63% for teacher leave fares and 80% for village court allowances in 2006 primarily to address a backlog of arrears. There appear to be large differences among Provinces.

While more Health Services Improvement Program funding was accessed by Provinces for health service delivery in 2006 than 2005, many Provinces seem to ignore this funding source. Provinces should use all means possible to support priority areas. Other donor initiatives such as the Road Maintenance and Rehabilitation Project also makes funding available for assisting with recurrent activities, but again not many Provinces are using it to address recurrent transport maintenance needs.

On average Provinces spent 200% or double the actual administration costs required. Administration spending increased by K7 million in 2006 and 82%, or K44.6 million, of spending on recurrent goods and services on administration was funded from internal revenue

APPENDIX A DETERMINATION APPORTIONING THE EQUALISATION AMOUNT

SI 157/2008



Intergovernmental Relations (Functions and Funding) Act 2008.

DETERMINATION APPORTIONING THE EQUALISATION AMOUNT.

I, **PATRICK PRUAITCH**, Minister for Treasury and Finance, by virtue of the powers conferred by Item 2 of the Schedule of the *Intergovernmental Relations (Functions and Funding) Act 2008* and all other powers me enabling hereby make the following determination:-

1. TRANSITIONAL INDIVIDUAL PROVINCE GUARANTEES.

For a fiscal year of the transition period, the proportion of the equalization amount for that fiscal year available for the total of the transitional individual province guarantees of all Provincial Governments is the sum of the following 2 amounts:-

- (a) K84,849,100 being the amount appropriated to all Provincial Governments in the fiscal year commencing on 1 January 2008 under the *Organic Law on Provincial Government and Local-level Government* for block grants, function grants and derivation grants; and
- (b) if the amount of GST distribution received by a Provincial Government for the fiscal year commencing 1 January 2008 under the *Goods and Services Tax Revenue Distribution Act 2003* is greater than the amount of GST distribution received by that Provincial Government for the relevant fiscal year of the transition period, the total of the differences between the 2 GST distribution amounts for each of those Provincial Governments.

2. TRANSITIONAL INDIVIDUAL LOCAL LEVEL GUARANTEES.

For a fiscal year of the transition period, the proportion of the equalization amount for that fiscal year available for the total of the transitional individual local level guarantees of all Local-level Governments is an amount of K38,984,200.

3. **LOCAL-LEVEL SHARE.**

For a fiscal year of the transition period, the local-level share, being the proportion of the equalization amount for that fiscal year available for distribution amongst Local-level Governments, is an amount equal to 2 per cent of that equalization amount.

4. **PROVINCIAL LEVEL SHARE.**

For a fiscal year of the transition period, the province share, being the proportion of the equalization amount for that fiscal year available for distribution amongst Provincial Governments, is the amount remaining after deducting from that equalization amount the total of the amounts calculated under Clauses 1, 2 and 3 for that fiscal year.

5. **MEANING OF TERMS.**

In accordance with Section 77 of the *Interpretation Act* 1975, the terms used in the determination have the same meaning as in the *Intergovernmental Relations (Functions and Funding) Act* 2008.

MADE this

12th

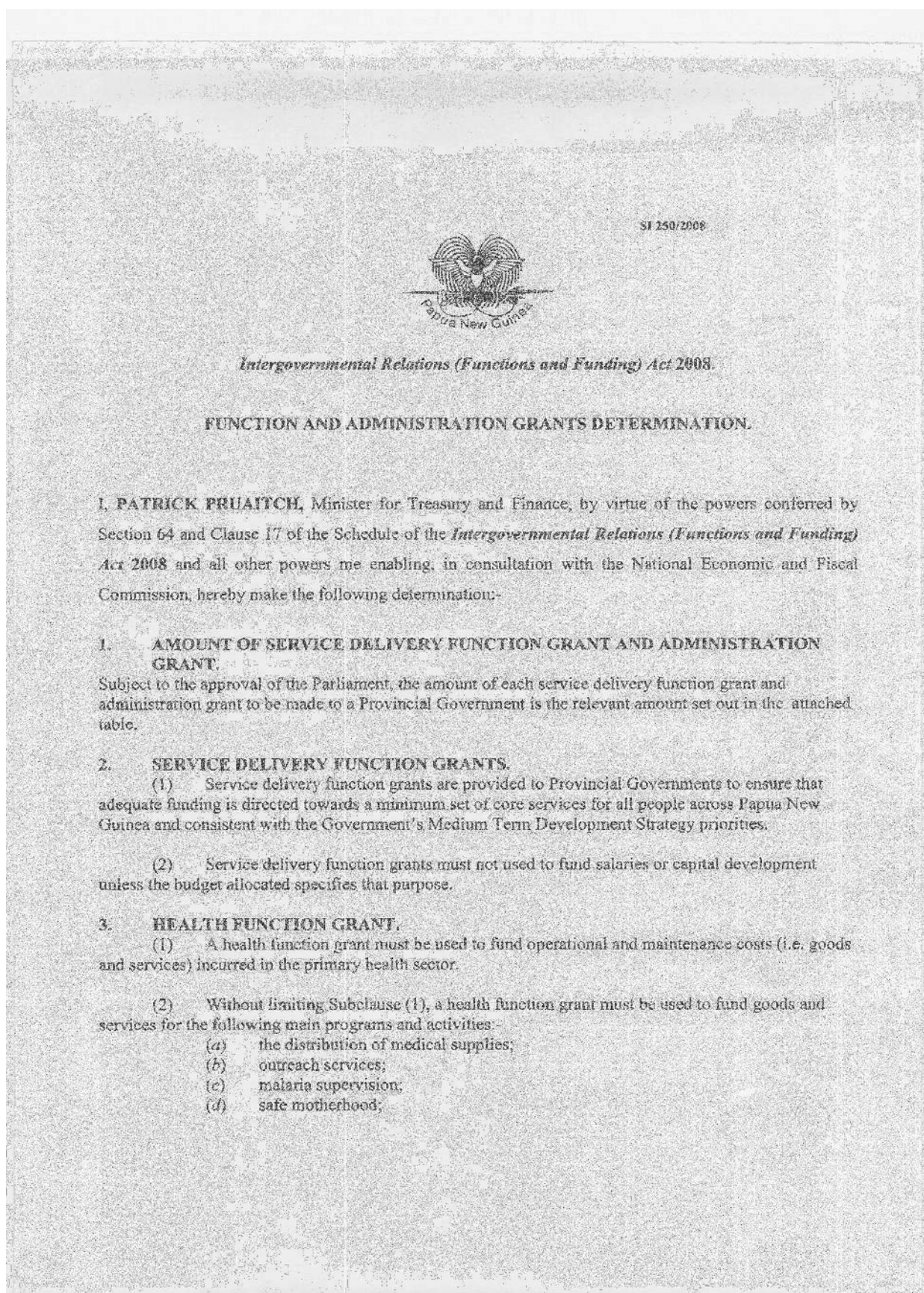
day of

May

, 2008.


MINISTER FOR TREASURY AND FINANCE.

APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION



- (e) immunization;
- (f) water supply and sanitation;
- (g) health service monitoring, review and performance agreements.

4. EDUCATION FUNCTION GRANT.

(1) An education function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the basic education sector.

(2) Without limiting Subclause (1), an education function grant must be used to fund the operational costs for elementary and primary education that are within the responsibilities of a Provincial Government, such as:-

- (a) the maintenance of primary schools; and
- (b) the procurement and distribution of school materials; and
- (c) the operation of district education offices in the province.

5. TRANSPORT INFRASTRUCTURE MAINTENANCE FUNCTION GRANT.

(1) A transport infrastructure maintenance function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the transport infrastructure maintenance sector.

(2) Without limiting Subclause (1), a transport infrastructure maintenance grant must be used to fund the maintenance costs of provincial roads, bridges, jetties, wharves, airstrips and airfields that are within the responsibilities of a Provincial Government.

(3) A transport infrastructure maintenance grant must not be used to fund all or any of the following:-

- (a) the construction of new roads;
- (b) the maintenance of buildings;
- (c) the major reconstruction or rehabilitation of unusable existing roads, bridges, wharves, jetties, airstrips or airfields.

6. VILLAGE COURT FUNCTION GRANT.

(1) A village court function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the village court sector.

(2) Without limiting Subclause (1), a village court function grant must be used to fund the operational and supervision costs incurred in the village court sector for the purchase of goods and services, such as uniforms, flags and badges.

(3) A village court function grant must not be used to fund the costs of salaries or allowances for village court officials.

7. AGRICULTURE FUNCTION GRANT.

(1) An agriculture function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the agriculture sector.

(2) Without limiting Subclause (1), an agriculture function grant must be used to fund primary production through support for supervision, training and extension activities to the agricultural and fisheries sectors, as well as for the export promotion of these products.


8. OTHER SERVICE DELIVERY FUNCTION GRANT.

An other service delivery function grant must be used to fund the recurrent goods and services costs for other sectors not covered by the service delivery function grants mentioned in Clauses 3 to 7, such as business development, community development and environment and conservation.

9. ADMINISTRATION GRANT.

An administration grant must be used to fund the costs of administrative overheads of a Provincial Government, excluding salaries.

MADE this *24th* day of *September*, 2008.


MINISTER FOR TREASURY AND FINANCE.

2009 Function and Administration Grants Determination

	Health Function Grant	Education Function Grant	Transport Infrastructure Maintenance Function Grant	Village Courts Function Grant	Agriculture Function Grant	Other Service Delivery Function	Administration Grant	Total Provincial Government Grants
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Madang	2,056.0	1,967.8	2,459.4	78.3	760.2	1,440.3	704.8	9,466.6
East Sepik	2,977.5	2,898.9	3,405.7	167.3	850.6	1,301.4	973.2	12,574.7
Sandaun	1,882.6	1,809.9	1,812.8	67.1	382.1	1,091.0	777.7	7,823.1
Manus	911.4	876.7	1,207.7	73.3	101.5	707.4	252.8	4,130.7
New Ireland	863.6	845.0	1,020.8	51.7	547.3	184.7	184.7	3,697.8
East New Britain	1,930.7	2,663.0	2,232.5	70.6	1,527.3	516.6	81.1	9,021.8
West New Britain	1,238.2	1,544.2	771.7	165.3	4,330.6	155.1	128.2	8,333.2
TOTAL	28,445.8	31,634.3	34,042.0	2,224.6	14,116.6	14,814.0	9,518.1	134,795.4

APPENDIX C: RESPONSIBILITIES SPECIFICATION EXERCISE MATRICES

Sector	Province	District	Local-level
Office of Administrator & Deputy Administrators	<ul style="list-style-type: none"> • Provide stationery, utilities, entertainment & domestic assistance and security, and maintain communication, office equipment, vehicles & furniture • In-service training for office staff, and travel to districts to conduct training • travel to LOCAL-LEVEL GOVERNMENTS, districts and NCD for information dissemination, liaison etc • Grant funding for Regional body membership etc 	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture 	
Internal Audit	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • In-service training for division staff • Professional association membership • District, LOCAL-LEVEL GOVERNMENT/School audit 	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture 	
LOCAL-LEVEL GOVERNMENT Administration	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • In-service training for division staff • District support/Supervisory visits to LOCAL-LEVEL GOVERNMENTS 	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • Supervisory visits to LOCAL-LEVEL GOVERNMENTS 	

	<ul style="list-style-type: none"> • Emergency response 		
Human Resources Development	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • Out-of-province and in-province training for staff • Payroll processing and staff restructuring 	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture 	
Policy, Planning & Research	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • In-service training for divisional staff • Policy dissemination, planning (provincial & district development plans) • Information management (data research, survey & database management) 	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture 	
Finance & Administration	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • In-service training for divisional staff • Budget preparation, presentation, monitoring & annual PAC appearance • Revenue collection & administration • Provision of provincial supplies & asset register maintenance 	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • In-service training for district/LOCAL-LEVEL GOVERNMENT staff • Maintenance of cash office, security & acquittals • Budget preparation, presentation, monitoring 	<ul style="list-style-type: none"> • Budget monitoring • Revenue collection & compliance

		<ul style="list-style-type: none"> • Revenue collection, compliance & administration 	
Legal Services	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • In-service training for divisional staff, government lawyer conference & continued legal education courses & procurement of legal books • Drafting legislation • Case representation in POM, filing/lodgement with National Court, company searches, private legal services, subscription to national court judgements & to national gazette • Professional association membership 		
Assembly	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture • In-service training for divisional staff • SRC mandated members' allowances, accommodation, transport, printing, parliamentary committees & PEC meetings • Provide stationery, utilities, entertainment & domestic assistance and security, and maintain communication, office equipment, vehicles & furniture 	<ul style="list-style-type: none"> • Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture 	<ul style="list-style-type: none"> • SRC mandated allowances, accommodation, transport • Rations, stationery & printing

Service Delivery Sectors

Sector	Province	District	Local-level
Agriculture	<ul style="list-style-type: none"> Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture In-service and training of divisional & program staff Supervision of district staff 	<ul style="list-style-type: none"> Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture Service delivery in-service training Extension visits& seed/tool distribution to farmers & schools Farmer training Information dissemination and field days Rice & copra mills & farmer transport subsidies 	
Commerce	<ul style="list-style-type: none"> Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture Training for divisional staff Supervision & identifying new business opportunities, developing proposals Tourism conferences, committees, cultural committees, tourism training, promotional materials and cultural events organisation 	<ul style="list-style-type: none"> Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture Project technical support (eg. SYOB, training etc) 	
Community Development	<ul style="list-style-type: none"> Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture In-service training for staff Sports development, facility maintenance 	<ul style="list-style-type: none"> Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture Grant monitoring & sports development & facility maintenance 	

	<ul style="list-style-type: none"> ▪ Youth extension-vocational skills training ▪ Child welfare-training & allowances ▪ Women's affairs-grants to youth councils 		
Education	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ In-service training for division staff ▪ Support for provincial education board ▪ School fee subsidies administration (provincial component & distribution of schools) ▪ Teacher leave fares ▪ Procurement & distribution of curriculum materials supply ▪ School establishment approval ▪ Teacher appointment/deployment ▪ Payroll administration (records, budgets TSC presentation & data management) ▪ Exam administration (Gr 8, 10 & 12) ▪ Pre-service training (elementary) ▪ In-service training ▪ Secondary school maintenance ▪ Procurement & distribution of elementary, primary & secondary school supplies 	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ Payroll administration (school resumption visits) ▪ Inspection & advisory (elementary, primary, secondary), provincial & national ratings conferences 	<ul style="list-style-type: none"> ▪ Maintenance of school buildings
Environment	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain 	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and 	

	<p>communication, office equipment, vehicles & furniture</p> <ul style="list-style-type: none"> ▪ In-service training for staff ▪ Environmental management (monitor compliance with plans & investigate environmental damage) ▪ Information promotion & dissemination 	<p>maintain communication, office equipment, vehicles & furniture</p>	
Fisheries	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ In-service training for division staff ▪ Supervision support for district fisheries offices 	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ Awareness & monitoring of local private fisheries ▪ Advise & extension services to new fishers 	
Health	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ Training for division/district program staff ▪ Support for provincial health board ▪ Health information system-monthly reports from HC to PHQ to Pom ▪ Supervision of districts, performance reviews & HC visits ▪ Disease control-outbreak management ▪ Environmental health-sewage/fishing boats, food markets & shops & water quality testing ▪ Distribution of medical supplies to health centres 	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ Support for district health management committees ▪ Supervision of HC & aid posts ▪ Patient transfer (HC to PHQ emergency) ▪ In-service training ▪ Rural health centre transportation-access to clinic extension points ▪ Maintenance of HC, medical equipment in HC & provision of non-medical supplies for HC ▪ Immunisation/MCH (vaccines 	<ul style="list-style-type: none"> ▪ Non-medical aid post supplies, maintenance of aid posts & medical equipment

	<ul style="list-style-type: none"> Health promotion-dissemination of print materials & radio spots 	<ul style="list-style-type: none"> collection & storage, maintenance, mobile clinics/outreach), village birth attendant training, school visits Disease control (village based outreach, bed net distribution etc) Water supply (establish tank based water supply system in villages) Distribution of medical supplies (distribution to aid posts) Health promotion (local group activities) Radios (emergency repair) 	
HIV	<ul style="list-style-type: none"> Provide stationery, utilities, maintain communication, office equipment, vehicles & furniture In-service training for division staff Support to provincial HIV/AIDS committee Public awareness & condom distribution (outreach visits, HC & Aid posts) Training of health staff & community counsellors 	<ul style="list-style-type: none"> Provide stationery, utilities, maintain communication, office equipment, vehicles & furniture 	
Infrastructure	<ul style="list-style-type: none"> Provide stationery, utilities, maintain communication, office equipment, vehicles & furniture In-service training for provincial program staff Policy development & project management Road, bridges, jetties & airstrip infrastructure maintenance 	<ul style="list-style-type: none"> Provide stationery, utilities, maintain communication, office equipment, vehicles & furniture Rural electricity—cost of providing electricity to district administrations District HQ communication—provision and maintenance of communication services, including district radios 	

Land Administration	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ In-service training for provincial program management staff ▪ Alienated land—collection & inspection of lease rentals, compulsory land acquisition, land valuation, support for provincial lands board & operation of provincial land information system ▪ Survey of alienated land & maintenance of survey equipment ▪ Support for physical planning board & provincial capital visits ▪ Customary land negotiations & land court hearing costs 	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, office equipment, vehicles & furniture 	
Natural Resource Management	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ Landowner consultation & liaison 	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture 	
Village Courts	<ul style="list-style-type: none"> ▪ Provide stationery, utilities, and maintain communication, office equipment, vehicles & furniture ▪ In-service training for provincial & district program management staff ▪ Support for peace & good order committee meetings 	<ul style="list-style-type: none"> ▪ Provide stationery & utilities, maintain communication, office equipment, vehicles & furniture ▪ Supervisory visits to village courts ▪ Support for district court magistrates' visits to VC's 	<ul style="list-style-type: none"> ▪ Inspection visits to village courts ▪ Provision of village court supplies (flages, uniforms, badges)

Sector	Province	District	Local-level
Police	<ul style="list-style-type: none"> Meet a quarter of cost of provide stationery, utilities, entertainment & domestic assistance and security, and maintain communication, office equipment, vehicles & furniture 		
Correctional Service	<ul style="list-style-type: none"> Provide stationery, utilities, entertainment & domestic assistance and security, and maintain communication, office equipment, vehicles & furniture In-service training for divisional staff Detention; feeding & clothing prisoners Transfer & repatriation of prisoners to home provinces 	<ul style="list-style-type: none"> Provide stationery, utilities, entertainment & domestic assistance and security, and maintain communication, office equipment, vehicles & furniture 	
NBC	<ul style="list-style-type: none"> Provide stationery, utilities, entertainment & domestic assistance and security, and maintain communication, office equipment, vehicles & furniture In-service training for divisional staff Operation of transmitter Travel for content development 	<ul style="list-style-type: none"> Provide stationery, utilities, entertainment & domestic assistance and security, and maintain communication, office equipment, vehicles & furniture 	

APPENDIX D: EXPLANATORY NOTE ABOUT THE COSTING STUDY

It may be tempting to assume that by funding provincial governments up to the level of the NEFC cost estimates, they should be adequately resourced to meet all their expenditure mandates. That assumption would be incorrect.

The costing study was done for the purpose of establishing relativities between provinces in terms of the cost of their expenditure mandates, as a basis for dividing up a limited pool of funding. Thus it was less important to be accurate about the total quantum than it was to be accurate about the differences between the cost of the same service being delivered in different provinces and districts.

At the time the costing study methodology was designed, PNG was experiencing some budgetary stress. It seemed highly unlikely that provincial funding would come even close to the total cost of expenditure mandates in the foreseeable future. Since both funding and actual expenditure had fallen so grossly short of any reasonable levels, it was decided that a conservative approach represented the most appropriate first step in establishing new benchmarks for both funding and expenditure.

A primary objective in designing the methodology was to be extremely conservative in the estimates, so that every single element of the costs could be readily justified. We wanted to be certain that we could confidently assert that any reduction in funding below the level of these estimates would certainly result in a reduction in service levels. We were less concerned with being able to confidently assert that this level of funding would certainly be sufficient for the services to be delivered in full. It was always anticipated that the study would provide a basis to build on in terms of understanding what might be appropriate funding levels, rather than the final answer.

Each activity cost is built up from input costs which are extremely conservatively estimated.

As an example, the operating budget for a single health centre or rural hospital is comprised of the following input items:

- 200 litres of kerosene per year
- 18 litres of bleach
- 120 cakes of soap
- 1 mop
- 1 bucket
- 10 x 13kg gas bottles (to power vaccine refrigerator)
- 1% of capital cost as a building maintenance allowance (based on a construction cost estimates of a standard health centre building design provided by Department of Works).

It was assumed that all rural health centres and hospitals operate without electricity, mains water or telephones. There was no allowance for ancillary staff (eg cleaners). It is assumed that patients provide all bedding and food, and medical equipment and drugs are provided by the National Government.

It would be dangerous to assume that this level of funding would actually be adequate to operate a health centre in accordance with PNG standards, particularly the larger rural hospitals which have 20 or 30 inpatient beds and operating theatres.

Some indication of how significantly the NEFC costing study may have underestimated costs can be gained from looking at the current funding levels for church-run health centres and rural hospitals. On the basis of the NEFC costing, the operating costs of running church health facilities in PNG is less than K5 million. The actual funding currently being provided to church health agencies to meet their operating costs (not including the separate salary grant) is K13 million. There is no anecdotal evidence to suggest that church health services are flush with money. Indeed, the opposite is the case. All the evidence is that they do a good job with relatively little resources.

In other words, the actual cost of church health facility operations may well be K13 million, not K5 million. If this is the case, it suggests that the NEFC cost estimates may have underestimated actual costs by as much as 60%.

There are some particular areas where substantial costs of service delivery were not included in the study:

No capital costs

No capital costs were incorporated into the costing other than for vehicles, boats and computer equipment. Replacement costs for these assets were allocated over an assumed asset life substantially longer than is usually used.

Provincial governments do have substantial capital cost responsibilities, in particular in relation to roads.

Road rehabilitation and emergency maintenance costs

Provincial governments are responsible for between 55% and 65% of the nation's road network. The national Transport Development Plan assumes that the cost of rehabilitating degraded provincial roads is a provincial cost responsibility. A rough estimate of the total capital cost for all provinces is between K7 to K14 billion.

No allowance was made for any capital, rehabilitation or emergency maintenance costs of provincial roads or bridges in the costing study. Only the regular, routine costs of maintenance were included in the costing. The assumed cost was around K10,000 per km per year for a gravel road and K7,000 per km for a sealed road.

No wage costs

No casual wage costs were included in the costing study. It was assumed that all necessary staff would be paid as public servants. In some provinces it is possible that there are significant numbers of health workers on the casual payroll. If they were to be no longer employed, this may result in the closure of health facilities. More information is needed before any assessment can be made about whether some essential casual wage costs should in some cases be added into the costing estimates.

Patient transfers

Cost estimates for the cost of emergency patient transfers were initially developed on the basis of statistics provided by the Department of Health as to the number of patients requiring emergency transfer from rural areas to provincial hospitals. The first cost estimate for this single expenditure item was over K120 million.

Since this cost represented just one element of the health budget, it was felt that such a large number had the potential to distort budgetary decisions by provinces (ie, that it would justify them spending most of their budget on patient transfers, which the Department advised as already over-prioritised in comparison with preventive expenditures such as adequately funding health centres – which might lessen the need for transfers for far less per capita expenditure). The cost estimates were reduced to around K20 million. Nevertheless, it is recognised that patient transfer expenses are demand-driven and can be very expensive. In determining the cost, it was assumed that transfers were always made by the cheapest possible route. No allowance was made for emergency helicopter flights, for example.

School operating costs

School operational funding is complicated in PNG because it is funded from four different sources. There has been a general assumption that provincial governments will contribute a total of around K20 million. The national government contributes around K35 million and the remaining costs are met by parents and school fund-raising, or are simply not met.

NEFC did not have the resources to undertake any realistic cost estimate of school operating costs. It was therefore assumed that the existing level of funding for school operations is adequate. It is almost certain that this assumption is not correct. It is hoped that this area of the cost estimates can be revised in future using some of the information collected through the NDoE unit costing study.

Curriculum materials

Under the national Curriculum Materials Policy, Provincial Governments are responsible for replacing curriculum materials in schools. It is estimated the total stock of school books needs to be replaced every 3-5 years. There was no information readily available on what this might cost, so NEFC simply omitted this cost from the calculation of the total education cost.

We justified not including this cost on the basis that, in the interests of efficient service delivery, this function should be resumed by the national government. In the meantime it is likely that donors will fill the gap. However, we are aware that at least three Provincial Governments spent large amounts of funding (in one case almost all their education funding) on this cost in recent years.

Urban services—water supply and sewerage; urban road maintenance

A handful of Provincial Governments in PNG are responsible for providing urban services such as water supply and sewerage. We know that they cannot provide these services on a cost recovery basis, because the PNG Waterboard makes a loss in all areas of its operations except its largest district of Lae, revenue from which is used to cross-subsidise its other operations. No cost estimates for these services were included in the costing study because they are asymmetric responsibilities (ie., only undertaken by some provincial government). Road maintenance responsibilities in some of the larger provincial capitals also fall to provincial governments because they are beyond the capacity of local governments.

APPENDIX E: GRANT CALCULATION IN 2009 BUDGET PROCESS

