Proposals for reform of intergovernmental funding in PNG

Presentation by NEFC to Special Governors Conference

Mt Hagen

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Outline of the presentation

Part 1:	Problems with the current system
Part 2:	How is funding shared between levels of government?
Part 3:	Is more tax-sharing the answer?
Part 4:	An alternative: equalisation
Part 5:	Proposed new funding arrangements

Slide 1

PART ONE:

PROBLEMS WITH THE CURRENT SYSTEM

Slide 2

Why service delivery is deteriorating

1. Not enough funding to pay for service delivery
2. Spending on the wrong things
3. Misappropriation
4. Poor management and poor supervision

The intergovernmental funding system affects the first reason

Part 1 Slide 3

The problem

- Under the current system, funds are distributed unfairly between provinces
- A few provinces are getting most of the pig
- Some provinces do not have enough

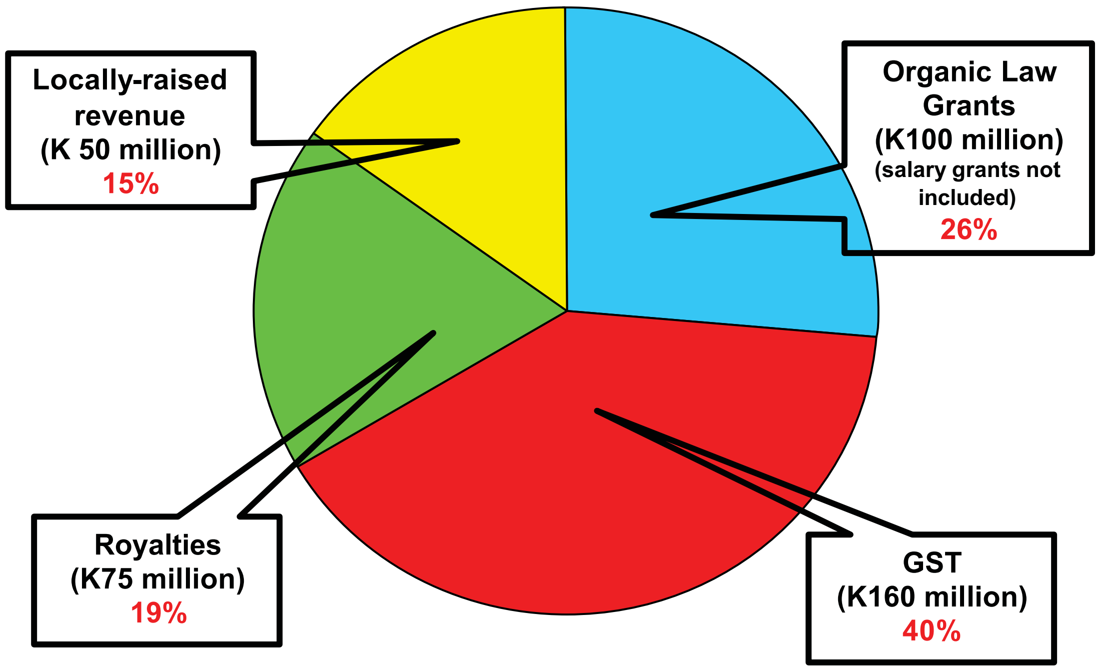
Part 1 Slide 4

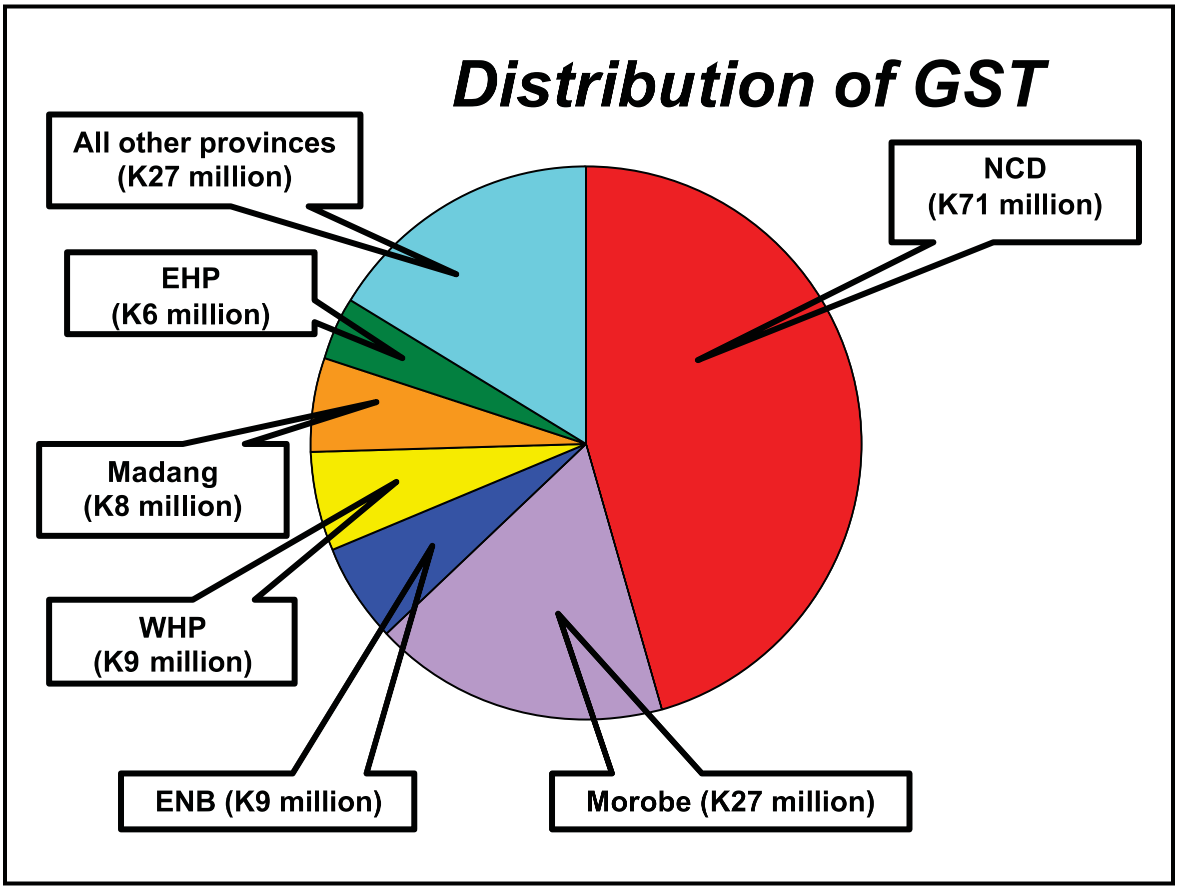
Why do some provinces not have enough?

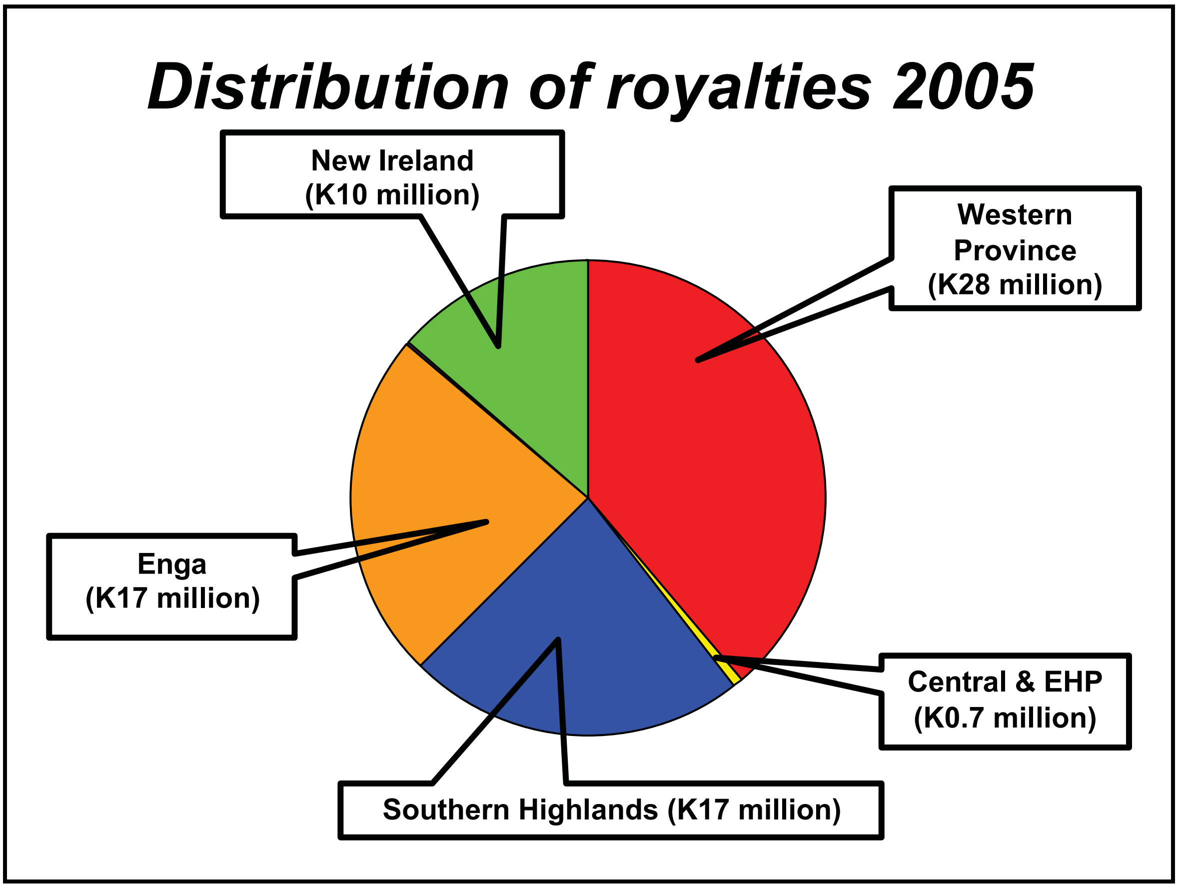
- Because 60% of the funding for goods, services and development in provinces is in the form of GST and royalties
- And GST and royalties are distributed to the provinces where they are raised
  - Most GST goes to only **6** provinces
  - Most royalties go to only **4** provinces

Part 1 Slide 5

Sources of provincial funding 2005




Distribution of GST
All other provinces (K27 million)
NCD (K71 million)
EHP (K6 million)
Madang (K8 million)
WHP (K9 million)
ENB (K9 million)
Morobe (K27 million)


Distribution of royalties 2005
New Ireland (K10 million)
Western Province (K28 million)
Enga (K17 million)
Central & EHP (K0.7 million)
Southern Highlands (K17 million)

The problem gets worse

- In some provinces, the costs of service delivery are much higher than in others
- Costs are usually higher in more remote provinces
- Remote provinces **NEED MORE** but often **GET LESS** in revenue

Funding is not related to the cost of service delivery

Part 1 Slide 6

Comparison of service delivery Costs

Southern Highlands:

Cost: **K47 per head**

Factors influencing cost:

- All district HQ accessible by road
- People live close together so it is cheaper to provide services to them
- (More people can use the same health centre)

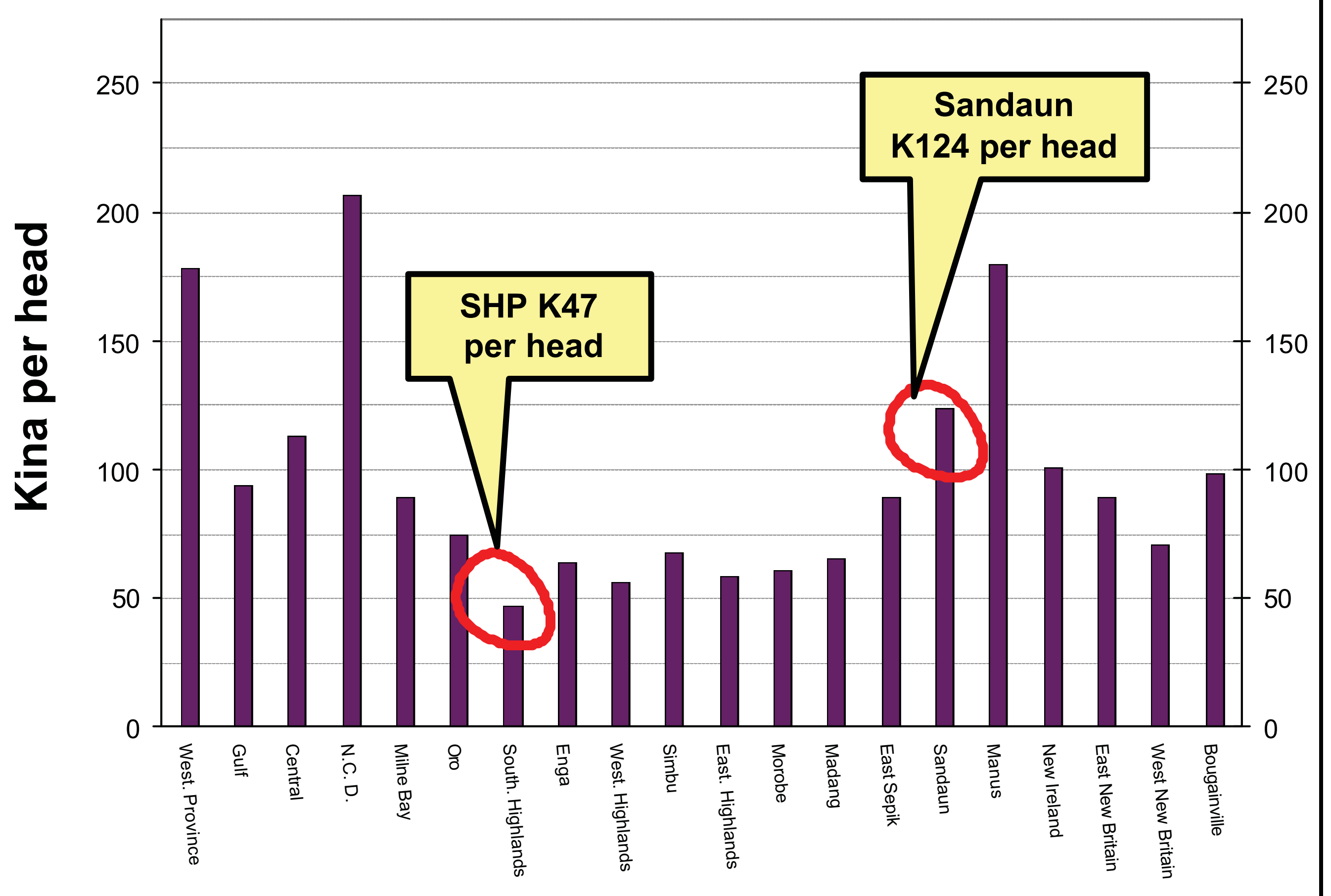
Sandaun:

Cost: **K124 per head**

Factors influencing cost:

- Few roads—most service delivery undertaken on foot
- 3 District HQ accessible only by air from Vanimo
- Large land area
- (Need more schools/health centres to reach people)

Part 1 Slide 7



Costs of provincial governments 2005

Some provinces have more Revenue than others

SHP revenue:

- Population: 670,000
- Revenue
  - Grants: K8 million
  - Other: K27 million
  - Total K35 million
- **Revenue: K53 per head**

Sandaun revenue:

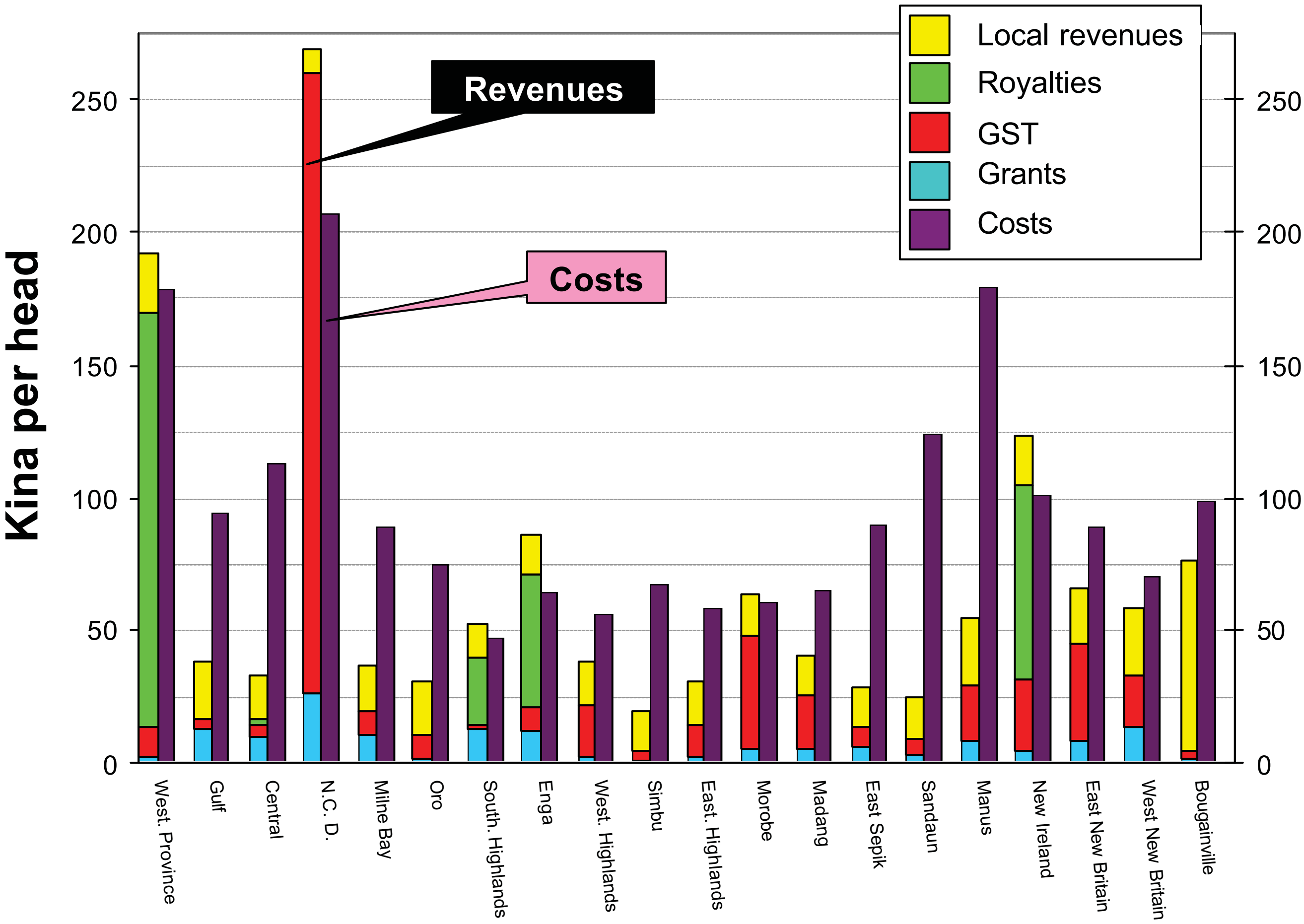
- Population: 210,000
- Revenue
  - Grants: K3 million
  - Other: K2 million
  - Total K5 million
- **Revenue: K25 per head**

Part 1 Slide 8

Impact of revenue on service delivery

- **Sandaun**
  - Needs K124 per head to pay for service delivery
  - Only K25 per head of revenue
  - Revenue is **20% of what is needed**
- **Southern Highlands**
  - Needs K47 per head to pay for service delivery
  - Has K53 per head of revenue
  - Revenue is **111% of what is needed**

Part 1 Slide 9



Revenue and costs of provincial governments 2005

How different provinces are affected

- Enga's revenue = **134%** of costs
- NCD's revenue = **130%** of costs
- New Ireland revenue = **122%** of costs

- Central revenue = **29%** of costs
- Simbu revenue = **29%** of costs
- Sandaun revenue = **20%** of costs

Part 1 Slide 12

How does each province do?

See handout:

Information on Costs and Revenues of Provincial Governments

Page 3

Part 1 Slide 7

Summary of part one

- The main problem is that some provinces do not have enough money to fund service delivery
- There is more than one solution
  - A **bigger pig** — national government gives more funding to poorer provinces
  - National government **shares more taxes with provinces**
  - Sharing the funding between provinces more fairly

Equalisation

Part 1 Slide 13

PART TWO:

HOW RESOURCES ARE SHARED BETWEEN LEVELS OF GOVERNMENT

Slide 14

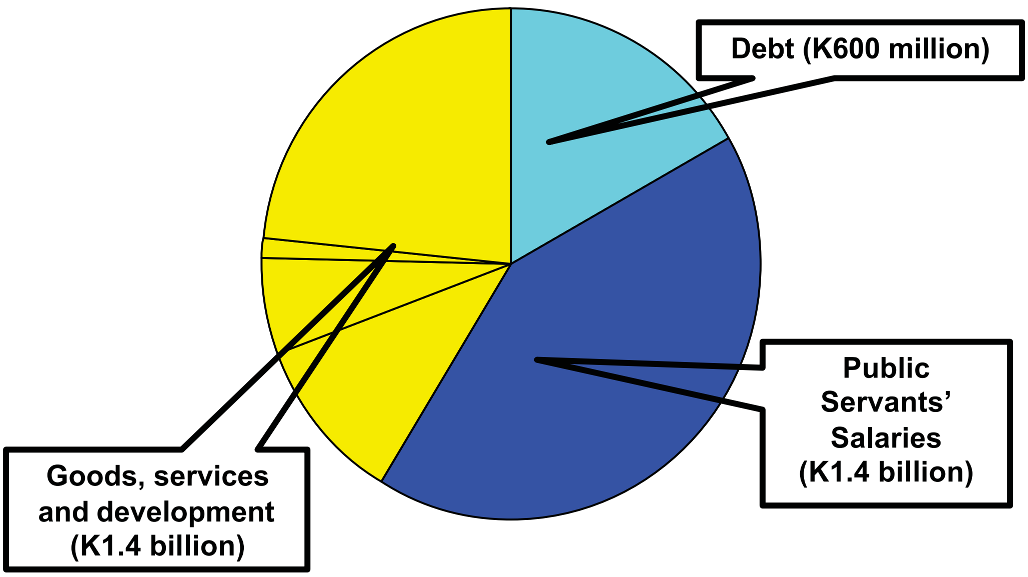
Where does the money go?

- The pie diagrams show how total government resources are currently being used
  - Includes GST and royalties
- Total government resources **K3.4 billion**
- Almost **60%** goes to debts and salaries (K2 billion)
- **40%** is left to pay for goods, services and development (**K1.4 billion**)

Part 2 Slide 15

How total government funding is spent

(2005 estimates)

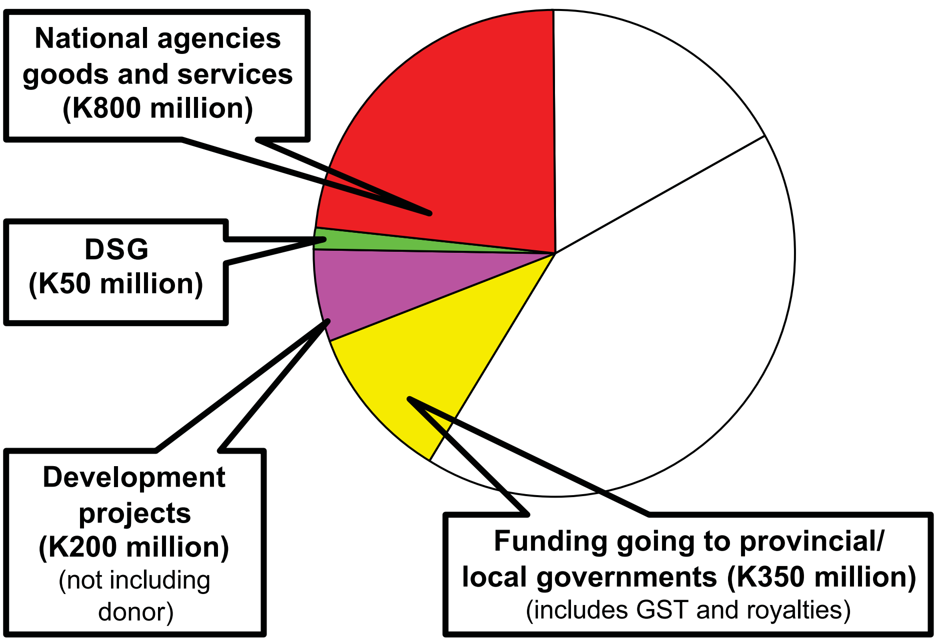


What happens to the K1.4 billion?

- National agencies get **K800 million** (red)
- MPs get **K50 million** provincial and district support grant (green)
- Development projects **K200 million**
    - Not including DSG
- Provinces get **K350 million** Provincial recurrent and development grants and tax transfers (yellow)

Part 2 Slide 16

What is available for distribution between national and provincial governments?



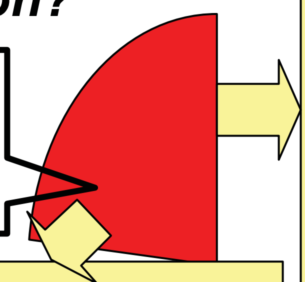
A significant proportion of funding is already going to provinces

- The National Government spends one quarter of its goods and services budget in provinces (K200 million out of K800 million)
- Other K600 million goes on POSF Parliament, office rental, court cases and total of 78 national government agencies

Part 2 Slide 17

What happens to the national government's K800 million?

National agencies' goods and services
K800 million



K200 million
SPENT IN PROVINCES:
Drugs K54 million
Church health services K14 million
Hospitals K14 million
Schools K46 million
Elections K22 million
Provincial Police K17 million
Prisons K10 million
Courts K14 million
Other K9 million

K600 million
NATIONAL SPENDING:
POSF K100 million
Office rental K70 million
Parliament K57 million
Court cases K51 million
Higher education K48 million
Defence K35 million
National / NCD police K28 million
Prime Ministers K28 million
Foreign Affairs K22 million
Gas Project K10 million
Other 66 agencies K151 million

If provinces are getting so much money, why is there still a problem with service delivery?

- Because of the way funding is shared between provinces

- The provinces are getting quite a big pig already, but most of the pig is going to only 5 tribes!

Part 2 Slide 18

Summary of Part 2

- Only **K1.4 billion** is available to spend on goods, services and development
  - About **K350 million** goes to provincial governments
  - Another **K200 million** is spent in provinces
- **K550 million** is spent on provincial service delivery—either by provinces or national govt.
- Should Provinces get more?
- If provinces do get more, something else will have to be cut
- Politicians must decide

Part 2 Slide 19

How to give all provinces enough funding

Three solutions:

1) Find a second pig — dealt with that
   - An issue for politicians to decide
   - Spending on other services will have to be cut
2) **Giving more national taxes to provinces**
3) Sharing what provinces already get more fairly

Part 2 Slide 20

PART THREE:

IS GIVING MORE NATIONAL TAXES TO PROVINCES THE ANSWER?

Slide 20

Sharing National taxes

- Some provinces are suggesting more national taxes should go back to provinces
- Some recent proposals:
  - ENB fiscal autonomy proposals
  - WNB log tax sharing proposal
  - Urban LLG resolution for a share of GST
- Bougainville financial package:
  - Almost all national taxes raised on Bougainville will be given back to Bougainville

Part 3 Slide 21

Some problems with tax-sharing

- If there were an ideal broad-based tax, it would be on agriculture
- BUT there is <u>no tax on agricultural exports</u>
- Therefore there is no tax to share with provinces that export agriculture
- More tax-sharing would do nothing for these provinces

Part 3 Slide 22

Why the government does not tax agricultural exports

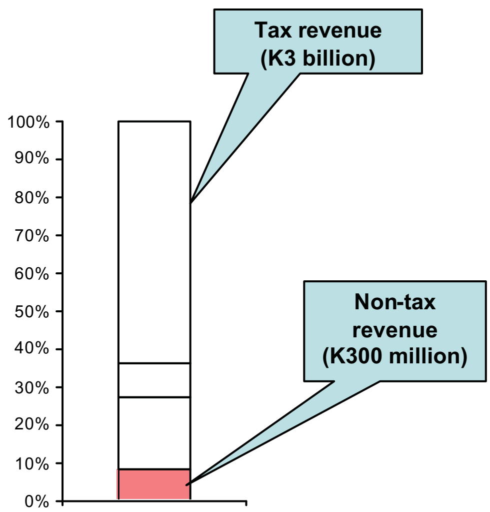
- Exports provide the money we need to buy essential imports
- If we tax our exports, farmers get less from selling cash crops
- We want to reward farmers for growing cash crops and growing the economy

Part 3 Slide 23

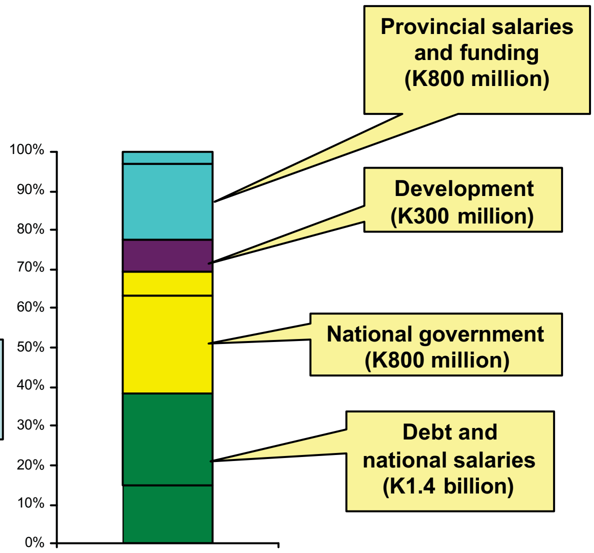
Bougainville: tax sharing arrangements

- Bougainville arrangements:
  - almost all taxes raised on Bougainville go back to Bougainville
  - in addition, the national government gives a further K10 million grant to Bougainville
- What would happen if this were applied to the whole of PNG?

Part 3 Slide 24



National Government revenue 2005 (K3.3 billion)



National Government spending 2005 (K3.3 billion)

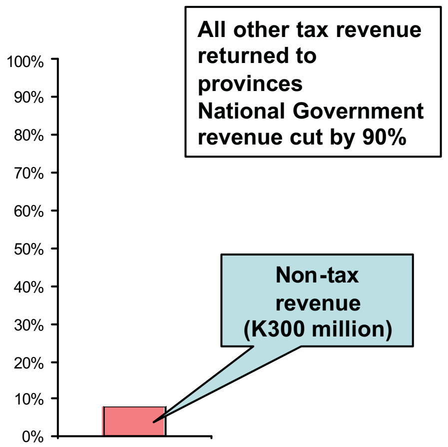
Current system (2005)

If Bougainville arrangements were applied to all provinces…

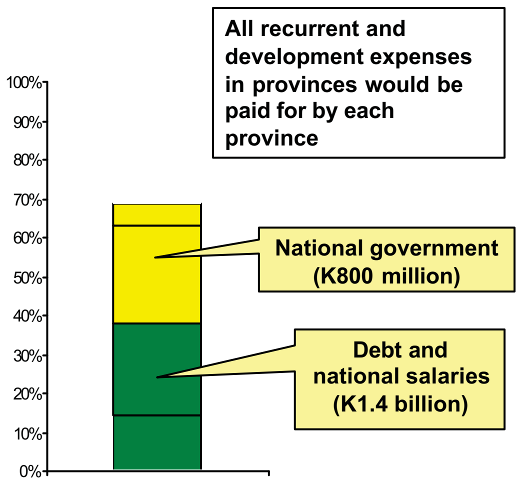
- Implications:
  - All national tax revenue would be go back to provinces
  - National Government revenue would be cut by 90%
  - Provinces would have to pay for all salaries of teachers and provincial staff
  - National Government would go broke
- Bougainville is a one-off solution to a political crisis
- It is not affordable for the whole country

Part 3 Slide 25

…this would be the result



Revenue that would be left with the national government (K0.3 billion)



Costs the national government would still have to meet (K2.4 billion)

Tax-sharing is not the answer

- **The more taxes the national government shares with <u>some</u> provinces, the less it is able to help others**

Part 3 Slide 26

The NEFC Solution

- The current system is unfair to most provinces—five of them are doing well, the other 15 are doing badly
- Tax-sharing is not the answer
- NEFC proposal is to share funding more fairly

Part 3 Slide 27

PART FOUR:

AN ALTERNATIVE APPROACH: EQUALISATION

Slide 28

NEFC proposed solution

- Funding arrangements should give all Papua New Guineans **equal access to services**

- The PNG Constitution calls for this
- Sharing is the Melanesian way
- Sharing is in accord with our Christian principles

Part 4 Slide 29

The Constitution calls for….

"equalisation of services in all parts of the country, and for every citizen to have equal access to … all services"

(*Second National Goal*)

"natural resources to be … used for the collective benefit of us all"

(*Fourth National Goal*)

Part 4 Slide 30

How do we achieve equal access to services?

- Not by giving each province the same kina per head
- Because costs in each province are different
- Instead, by giving each province enough funding to deliver a similar set of basic services to their people

Part 4 Slide 31

Example of different costs

- To deliver drugs to all health centres in the province, it costs:
  - **K1 million** in Sandaun
  - **K0.1 million** in Eastern Highlands
- Therefore, Sandaun needs 10 times more funding than EHP to deliver the same service even though EHP has more than twice as many people as Sandaun

Part 4 Slide 32

How do we give each province enough funding to deliver services?

- The solution: Pool grants and transfers and share them between provinces according to need
- **Equalisation =** sharing funding between provinces based on the cost of service delivery

Part 4 Slide 33

PART FIVE:

PROPOSED NEW FUNDING ARRANGEMENTS

Slide 34

Overview of the proposed new funding arrangements

- **Vision:** each person in PNG has equal access to services
- **Policy:** give each province enough funding to deliver basic services
- **Means:** sharing funding between provinces according to the cost of services (**equalisation**)

Part 5 Slide 35

General Principles

- Funding should be based on the service delivery responsibilities of provinces and LLGs
- Funding should be linked to the <u>actual cost</u> of delivering services
- Revenues from all sources should be taken into account
- Funding arrangements should be affordable

Part 5 Slide 36

Steps used to develop the new funding arrangements

1. What services are provinces responsible for?
2. How much does it cost to pay for those services in each Province and district?
3. How much revenue does each Province have to pay for those services?
4. How much funding does each Province need?
5. How can funding be more fairly distributed?

Part 5 Slide 37

Step 1: What services are provinces assumed to be responsible for?

- NEFC has assumed that provinces and LLGs are responsible for the list of services shown on projector 2
- This list was developed after extensive consultation with provinces and national agencies
    - (see yellow handout)
- The list can be changed, and costing will be adjusted accordingly

Part 5 Slide 38

List of provincial functions (not including NCDC)

- Rural **health** services
- Rural **water supply**
- **Schools** (2/3 of subsidy provided by national government)
- **Agricultural** and fisheries extension
- **Business development**
- Provincial and district **roads**
- **HIV-AIDs** programs
- **Village courts** and land mediators
- **Land** administration (some aspects)
- **Natural resource** development (some aspects)
- Provincial **Politicians**
- **Community development**

Part 5 Slide 39

National functions supported by provinces

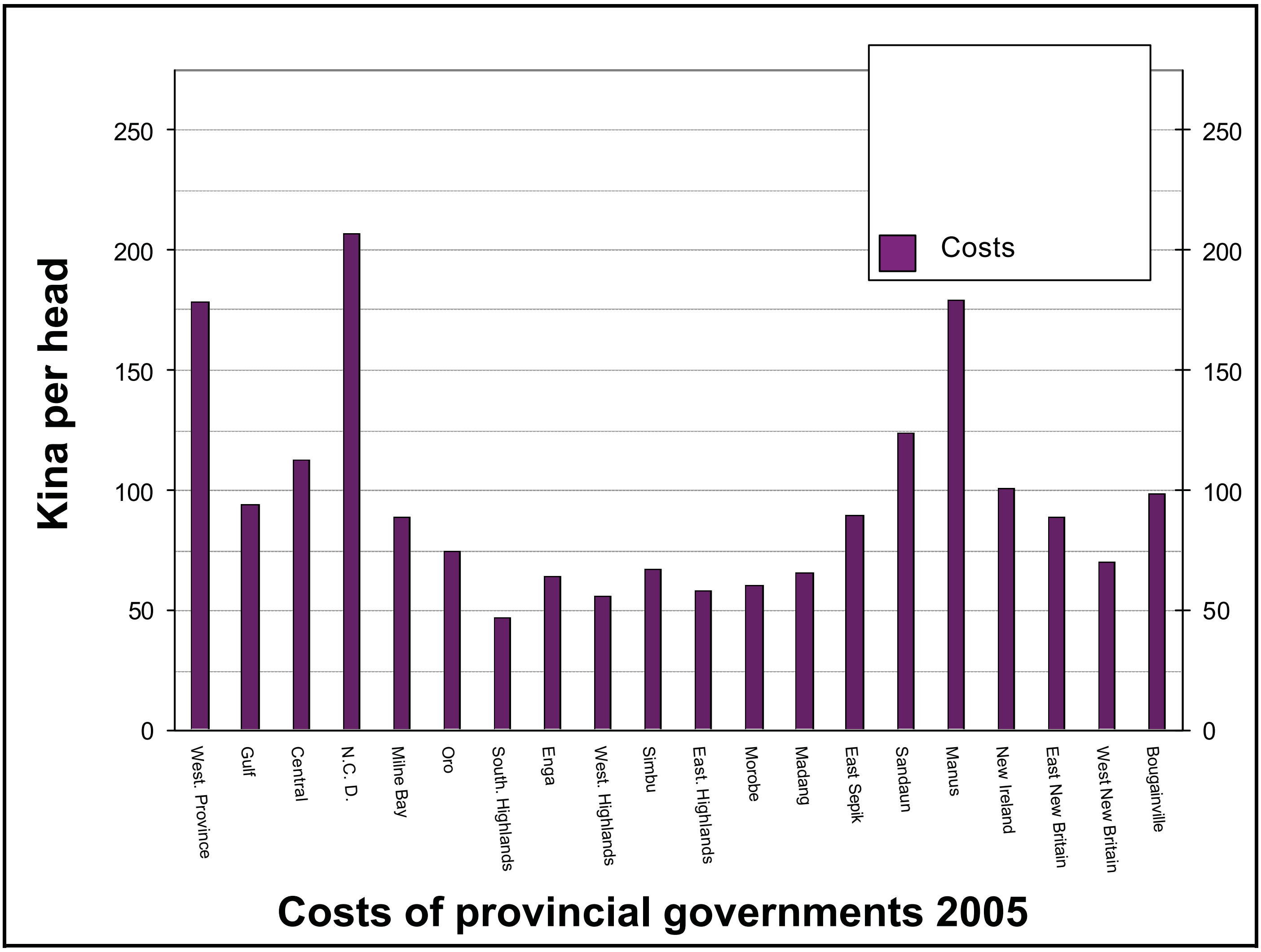
- Police
- Prisons
- Courts
- Provincial hospitals
- NBC

Part 1 Slide 7

Step 2: How much does it cost to deliver these services in each province/district

- NEFC has estimated the cost of service delivery for:
  - Each province and each district
  - Each sector of service delivery
- Staff of each district and sector spoken to
- Number of facilities and roads counted
- Travel routes for each district identified and measured
- Cost of fuel, etc. recorded in each province
  - *(EM on methodology)*

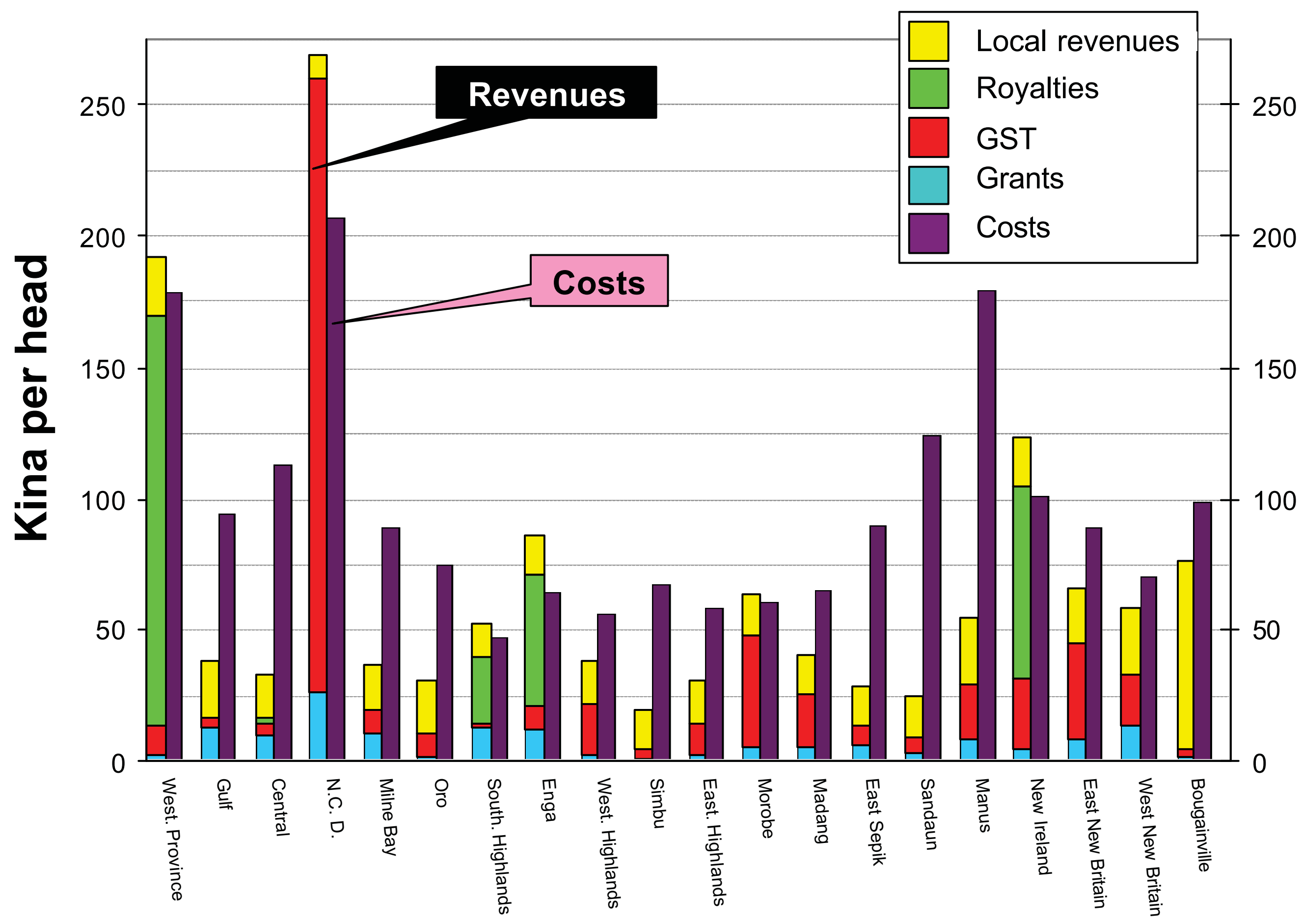
Part 5 Slide 40


Kina per head
250
200
150
100
50
0
Costs
West. Province
Gulf
Central
N.C. D.
Milne Bay
Oro
South. Highlands
Enga
West. Highlands
Simbu
East. Highlands
Morobe
Madang
East Sepik
Sandaun
Manus
New Ireland
East New Britain
West New Britain
Bougainville
Costs of provincial governments 2005

Step 3: How much revenue does each province have to provide these services?

- All recurrent revenues received under the current system are shown:
  - Grants (blue) (but not staffing grants and development grants)
  - GST (red)
  - Royalties (green)
  - Locally-raised revenues (yellow)

Part 5 Slide 41



Revenue and costs of provincial governments 2005

Step 4: How much funding does each province need?

- Each provinces **need = costs – revenue**
- Some provinces have more revenue than costs—they do not need extra funding
- Most provinces have less revenue than costs—they need extra funding

Part 5 Slide 42

Provinces that do not have enough

- Sandaun revenue = **20%** of costs
- Simbu revenue = **29%** of costs
- Central revenue = **29%** of costs
- Manus revenue = **30%** of costs
- East Sepik revenue = **32%** of costs
- Milne Bay revenue = **41%** of costs
- Gulf revenue = **41%** of costs
- Oro revenue = **41%** of costs
- EHP revenue = **52%** of costs
- Madang revenue = **62%** of costs
- WHP revenue = **68%** of costs
- ENB revenue = **75%** of costs
- WNB revenue = **82%** of costs

Part 5 Slide 43

Step 5: How can funding be more fairly distributed?

- Provinces currently have K350 million to deliver services
- We need to share this revenue more fairly, based on the cost of delivering services
- Equal kina-per-head does not achieve this
- Tax-sharing does not achieve this

= EQUALISATION

Part 5 Slide 44

What is equalisation?

- To equalise, we need to:
  - **pool funding** and
  - share it between provinces according to need
- At the moment, there is a Pool of Organic law grants (**K100 million**) shared on an equal kina-per-head basis
- Our proposal is for a different sharing arrangement based on need

Part 5 Slide 46

(Basic Services) Transfer Pool

- The Pool will help provinces pay for the costs of delivering services
- **The bigger the pool, the more we can help all the provinces fill their needs**
- Currently, the Pool of grants alone is not enough

Part 5 Slide 47

Four ways of making the Pool bigger

Scenario **1**: Pool **Grants only**
(distribute differently)

Scenario **2** : Pool **Grants and GST**

Scenario **3**: Pool **Grants and Royalties**

Scenario **4**: Pool **Grants, Royalties and GST**

(Governors' handout of costs and revenue information shows impact of each scenario on each province)

Part 5 Slide 48

Scenario 1: Pool Grants only

- Pool and share grants on the basis of need
- Currently the pool is K100 million = current total of all provincial and LLG recurrent grants
- Each province keeps their GST, royalties and internal revenue

Part 5 Slide 49

Scenario 1 Outcome

- K100 million does not help provinces to meet their need very much
- Outcome:
  - 4 provinces unable to pay half of costs
  - 10 provinces unable to pay 60% of costs
  - 4 provinces get more than what they need

Part 5 Slide 50

Scenario 2: Pool Grants and GST

- The current pool is K100 million
- Add K160 million GST
  = Total pool K260 million
- Each province keeps their royalties and internally-generated revenue

Part 5 Slide 51

Scenario 2 Outcome

- Total pool: K260 million
- Outcome:
  - Every province can fund at least 70% of their costs
  - No province gets more than they need

Part 5 Slide 52

Scenario 3: Pool Grants and Royalties

- The current pool is K100 million
- Add K75 million royalties
  = Total pool K175 million
- Each province keeps their GST and internally-generated revenue

Part 5 Slide 53

Scenario 3 Outcome

- Total pool K175 million
- Outcome:
  - Every province can fund at least 60% of their costs
  - Only one province gets more than they need

Part 5 Slide 54

Scenario 4: Pool Grants, GST and Royalties

- The current pool is K100 million
- Add K75 million royalties and K160 million GST
  = Total pool K335 million
- Each province keeps their internally-generated revenue

Part 5 Slide 55

Scenario 4 Outcome

- Total pool K335 million
- Outcome:
  - Every province can fund at least 75% of their costs
  - No province gets more than they need

Part 5 Slide 56

Other elements of the package

- Formula for sharing the pool each year?
- What kind of grants?
- Freedom to raise additional revenues?
- Timetable for implementation?
- Transitional arrangements?

Part 5 Slide 57

Formula for sharing the Pool each year?

- Formula:
  grants (transfers) = costs - revenues
- NEFC would recalculate formula each year
  - Revenues change each year
  - Costs would need to be reviewed periodically
- Formula set out in Organic Law

Part 5 Slide 58

Pool grants

- **Block grant**
  - Costs of political and administrative overheads
- **Function grants**
  - Fund health, education, village courts, infrastructure maintenance
  - New Agriculture Function Grant
- **District service delivery grants**
  - Covers costs of service delivery borne at district level

Part 5 Slide 59

Non-Pool grants

- **Development grants** funded separately from development budget (not from Pool)
  - Phase 2: NEFC could make recommendations on fairer distribution of development funding
  - Costing information shows which provinces have more infrastructure than others
- **Staffing grants** funded separately (not from Pool)
- Abolish **Derivation Grant—**replace with **Agriculture Function Grant**

Part 5 Slide 60

Timetable for implementation

- Organic Law changes need minimum 6 month lead time
- No opportunity to implement before 2007 budget
- Proposed commencement after 2007 election
- First year of operation 2008 budget

Part 5 Slide 61

Timetable

- **February 2006**: Proposals go to NEC
- **May 2006**: Organic law amendments gazetted
- **June 2006**: First vote
- **November 2006**: Second vote
- **June 2007**: Grant recommendations made to NEC
- **Jan 2008**: New system commences

Taxation reform

- Remove impediments to provincial and local revenue-raising
- Simplify requirements in Organic Law
- Most provinces still have a small tax base and will rely mainly on grants

Part 5 Slide 62

Transitional arrangements

- Proposals show how arrangements would operate when fully implemented
- Need to allow transition period to adjust to changes in revenue
- Timing: 3-5 years
- Possible provisions to ensure no province is worse off
- Interim GST distribution continues for further year

Part 5 Slide 63

Summary

- Objective:
  - Ensure that basic goods and services reach all the people of PNG
  - To do this, the system should give all provinces the funds they need to deliver basic services
- How the system would work:
  - **Pool** resources available for Provinces
  - Distribute according to **need**
- Critical issue to be decided:
  - How big should we make the Pool?
  - **Where will the money come from**?

Part 5 Slide 64