

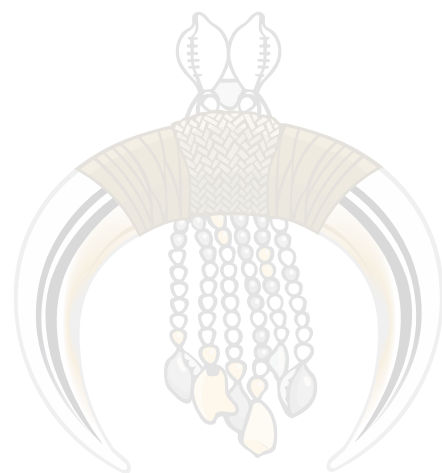
National Economic and Fiscal Commission

2025 Budget Fiscal Report



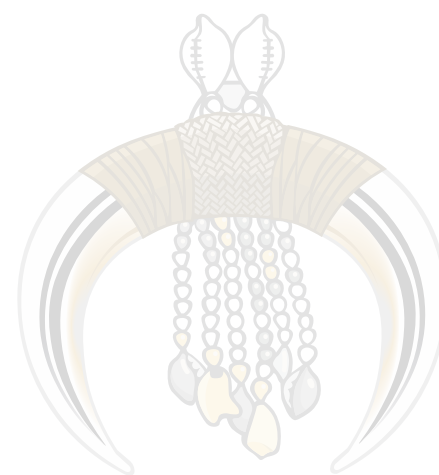
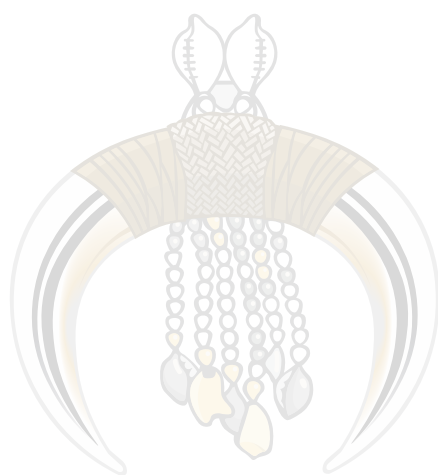
Additional copies of this report can be downloaded from the NEFC website:

www.nefc.gov.pg



2025 Budget Fiscal Report





CONFIDENTIAL
02

I Certify the above to be a correct record of the
Decisions reached by the National Executive Council



GRACE SO-ON Secretary, NEFC

**MINISTER FOR RURAL AND
ECONOMIC DEVELOPMENT**

JAMES MARAPE

Chairman

Date: 25th July 2024

Distribution: PRIME MINISTER/MINISTER FOR JUSTICE & ATTORNEY GENERAL/MINISTER FOR RURAL & ECONOMIC DEVELOPMENT/MINISTER FOR TREASURY/MINISTER FOR PROVINCIAL & LOCAL LEVEL GOVERNMENT AFFAIRS/NATIONAL ECONOMIC & FISCAL COMMISSION/TREASURY/PROVINCIAL & LOCAL LEVEL GOVERNMENT AFFAIRS/PRIME MINISTER & NEC/JUSTICE & ATTORNEY GENERAL/

Foreword



I am pleased to present the 2025 Annual Budget Fiscal Report, the eighteenth edition of the National Economic and Fiscal Commission (NEFC) 's annual publication.

The main objective of the Annual Budget Fiscal Report is to create a strong basis for informed public policy. It focuses on the key objectives of fiscal decentralization, aligning with the government's development goals and the ambitious Vision 2050.

To achieve these objectives, national and sub-national entities must balance promoting economic growth and financing essential service delivery. This report provides a thorough understanding of how Provincial Governments generate, collect, and report their revenues, as well as their utilization of national government funding as specified in the Intergovernmental Relations (Functions & Funding) Act of 2009.

A major highlight this year has been the consultation with the national agencies on Intergovernmental Financing Arrangement Review (IGFAR)- National Agencies Consultation and Target (Case) Studies conducted by the NEFC, the Department of Treasury, and 13 other key agencies. Progress in 2024 has been encouraging, highlighted by the successful completion of the National Agency consultations and Case Studies conducted across the eight provinces (Western Highlands, Eastern Highlands, Morobe, East Sepik, Milne Bay, Western, East New Britain, and New Ireland).

The current system has encountered challenges, many of which have been discussed in previous editions of this report. The review systematically addressed these issues, incorporating collective perspectives from provincial administration representatives, Districts, Provincial Health Authorities, City Authorities, Local-Level Governments, and various members of civil society.

The Review is envisioned to pave the way for gradual improvements in the system in the years to come.

Throughout, the NEFC remains steadfast in its role as an independent advisor to the government on fiscal and economic matters, particularly on agendas related to intergovernmental financing reforms.

In conclusion, I extend the Commission's hope that this publication proves valuable to readers and decision-makers. We welcome any observations or suggestions that may enhance the use of this publication.



Patrick Kennedy Painap
Chairman & Chief Executive Officer

Executive Summary

Each year, the National Economic & Fiscal Commission (NEFC) is required by law to submit a report to the Government and Parliament through the Minister for Treasury. This report covers its operations and the determination of function grants for Provincial and Local Level Governments (LLGs). According to Section 69 of the Intergovernmental Relations (Functions and Funding) Act 2009 and Section 117(9) of the Organic Law on Provincial & Local Level Governments, the Minister for Treasury must present the Annual Budget Fiscal Reports to Parliament.

This report summarizes the 2025 Budget Fiscal Report, which includes the function grant determinations for the 2025 fiscal year, as well as key operational highlights of the NEFC in 2024. The following sections will provide more detailed information on these achievements.

The story of reforms to our intergovernmental financing system spans more than a decade. It's a story of building a system based on the principle of equalization and the belief that funding should always align with responsibilities. While the system has served us well, it's important to recognize how much has changed throughout these reforms.

Since 2009, over K7.8 billion in function grants and an additional K7 billion in GST have been allocated. These are just two of the major fiscal transfers; when considering other sources like SIP funds, PIP, and donor grants, the total amount of fiscal support for sub-national governments has been substantial.

This increased funding has played a critical role in improving our service delivery systems. However, with the growth in funding, we also have a shared responsibility to ensure these resources go beyond just financial support, they must drive real improvements in service delivery.



The total Function Grant Determination for 2025 is K847.5 million, an increase of K76.2 million compared to the previous year. The table below shows the allocation of function grants for 2025 compared to 2024.

(Kina in millions)	2025	2024	Variance
Provincial Government Function Grants *	K703.4m	K655.6m	K47.8m
Local-Level Government Function Grants	K144.1m	K115.7m	K28.4m
Total	K847.5m	K771.3m	K76.2m
<i>Major Sectors</i>			
Health	K141.4m	K133.3m	K8.1m
Education	K166.0m	K155.1m	K10.9m
Transport Infrastructure	K207.5m	K194.6m	K12.9m

* This includes the health function grants which now go directly to the Provincial Health Authorities (PHAs) and not through the provincial governments.

APPENDIX D: NEC DECISION 168/2024 APPROVAL OF THE INTERGOVERNMENTAL FINANCING ARRANGEMENT REVIEW (IGFAR)

CONFIDENTIAL

PAPUA NEW GUINEA GOVERNMENT
MINISTER FOR RURAL AND ECONOMIC DEVELOPMENT

Decision No: 168/2024 **Meeting No: 13/2024**

Subject: INTERGOVERNMENTAL FINANCING ARRANGEMENT REVIEW



On 24th July 2024, Council:

- noted the content of Policy Submission No. 102/2024;
- approved the Intergovernmental Financing Arrangement Review (IGFAR) Project to review the current Intergovernmental Financing Arrangements and the *Intergovernmental Relations (Functions and Funding) Act 2009*;
- directed that the National Economic & Fiscal Commission and the Department of Treasury lead the Review, supported by the Provincial and Local Level Service Monitoring Authority (PLLSMA) Sub-Committee on IGFAR agencies;
- noted the PLLSMA Meeting Resolution 20-2/2020 and directed the PLLSMA through its Sub-Committee on IGFAR, other relevant national agencies, and sub-national administrations including Provinces, Districts and LLGs to comply with and support this review exercise;
- noted the Implementation and Reporting Plan;
- noted the IGFAR Budget Plan for Phases 3 and 4; and
- noted the IGFAR Sub-national Consultation Report and the findings and recommendations therein.

CONFIDENTIAL

APPENDIX C: NEC DECISION 167/2024 REVOCATION OF PREVIOUS NEC DECISION TO AMALGAMATE NATIONAL ECONOMIC & FISCAL COMMISSION AND DEPARTMENT OF TREASURY

CONFIDENTIAL


Decision No: 167/2024 **Meeting No: 13/2024**

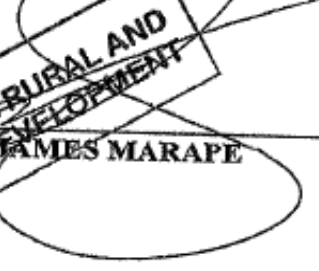
Subject: REVOCATION OF PREVIOUS NEC DECISION TO AMALGAMATE NATIONAL ECONOMIC & FISCAL COMMISSION AND DEPARTMENT OF TREASURY

On 24th July 2024, Council:

- noted the content of Policy Submission No. 101/2024; and
- approved to amend Decision No. 15/2018 by rescinding the decision to amalgamate the National Economic and Fiscal Commission with the Department of Treasury.

I Certify the above to be a correct record of the Decisions reached by the National Executive Council


GRACE SO-ON Secretary, NEC


JAMES MARAPE Chairman

Date: 25th July 2024

Distribution: PRIME MINISTER/MINISTER FOR JUSTICE & ATTORNEY GENERAL/MINISTER FOR RURAL & ECONOMIC DEVELOPMENT/MINISTER FOR TREASURY/NATIONAL ECONOMIC & FISCAL COMMISSION/TREASURY/PRIME MINISTER & NEC/JUSTICE & ATTORNEY GENERAL/

CONFIDENTIAL

TABLE OF CONTENTS

CHAPTER 1:	INTRODUCTION	2
1.1	COUNTRY PERSPECTIVE- PAPUA NEW GUINEA (PNG).....	3
1.2	THE FISCAL GAP	4
1.3	REFORMS ON INTERGOVERNMENTAL FINANCIAL ARRANGEMENTS (RIGFA)	5
1.4	TYPES OF GRANTS.....	5
1.5	ROLE OF THE NEFC	6
CHAPTER 2:	KEY ACHIEVEMENTS OF THE NEFC IN 2024	7
2.1	OPERATIONAL HIGHLIGHTS	7
2.2	THE CREATION OF THE MINISTRY OF RURAL AND ECONOMIC DEVELOPMENT: A NEW CHAPTER FOR NEFC'S GROWTH 8	8
2.3	SYSTEM REFORMS.....	8
CHAPTER 3:	ANNUAL BUDGET CYCLE	9
3.1	REVENUE ESTIMATES.....	9
3.2	EXPENDITURE PLANS	9
3.3	DEFICIT OR SURPLUS.....	10
3.4	LINKING THE BUDGET TO LOCAL GOVERNANCE.....	10
CHAPTER 4:	THE EQUALIZATION AMOUNT	12
4.1	CALCULATION OF THE EQUALIZATION AMOUNT- 2025.....	12
4.2	APPORTIONING THE EQUALIZATION AMOUNT BETWEEN PROVINCIAL AND LOCAL-LEVEL GOVERNMENTS ...	13
4.3	CHAPTER FOUR: RECOMMENDATIONS	14
4.4	PROVINCIAL DISTRIBUTION	15
4.5	LLG DISTRIBUTION	15
CHAPTER 5:	CALCULATING THE FUNCTION GRANTS	17
5.1	SUMMARY OF LEGISLATIVE PROVISIONS	17
5.2	THE FRAMEWORK FOR DETERMINING FISCAL NEEDS OF PROVINCIAL AND LOCAL-LEVEL GOVERNMENTS ..	17
4.2	18
4.2.1	Fiscal Needs Amounts for Provincial Governments	18
5.2.2	Fiscal Needs Amounts for Local-Level Governments	18
5.3	ESTIMATING THE COST-OF-SERVICE DELIVERY	18
5.4	COST OF SERVICE ESTIMATE.....	19
5.5	ASSESSED REVENUES.....	20
5.6	NATIONAL GOODS AND SERVICES GRANTS.....	20
5.6.1	Goods and Services Tax.....	20
5.6.2	Bookmakers Tax.....	20
5.6.3	Own-source revenue	20
5.6.4	Mining and Petroleum Royalties.....	21
5.6.5	Assessing Revenues.....	22
5.7	CALCULATING FISCAL NEEDS OF THE PROVINCES	22
5.8	CALCULATING INDIVIDUAL PROVINCE SHARES	23
5.9	INDIVIDUAL LOCAL-LEVEL GOVERNMENT SHARE	24
5.10	A NOTE ON CALCULATING THE DETERMINATION	25
5.11	RESOURCE-RICH PROVINCES & THE FUNDING ARRANGEMENTS.	26
CHAPTER 6:	CONDITIONS ATTACHED TO THE USE OF THE FUNCTION AND ADMINISTRATION	
GRANTS	27	
6.1	SERVICE DELIVERY FUNCTION GRANTS.....	27
6.2	ADMINISTRATION GRANTS.....	27
6.3	MINIMUM PRIORITY ACTIVITIES AND PERFORMANCE INDICATORS.....	28
6.4	IMPROVING COMPLIANCE WITH CONDITIONS FOR FUNDING	30
CHAPTER 7:	FINANCIAL PERFORMANCE AND COMPLIANCE	31
7.1	PROVINCIAL EXPENDITURE REVIEW	31
7.2	PGAS TO IFMS TRANSITION PHASE	31
7.3	FUNCTION GRANTS- WARRANTING AND CASH RELEASE	32
CHAPTER 8:	INTERGOVERNMENTAL FINANCING ARRANGEMENT REVIEW (IGFAR)	35

CHAPTER 9:	ASSISTING THE REFORM PROCESSES.....	37
9.1	ANTI-CORRUPTION- AN INTEGRAL STRATEGIC COMPONENT FOR IG FAR.....	37
	9.1.1 Section 187H of the Constitution sets out the Enabling Legislation.....	38
	9.1.2 Strategic Initiatives and Measures.....	39
9.2	AUTONOMOUS BOUGAINVILLE GOVERNMENT (ABG) COST OF SERVICES STUDY.....	39
	9.2.1 What are the Key Uses of this Report?	39
	9.2.2 The Situation.....	40
	9.2.3 The Key Findings.....	40
	9.2.4 The Key Recommendations	43
	9.2.5 Other Observations.....	44
CHAPTER 10:	APPENDICES:	45
•	APPENDIX A: DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT.....	45
•	APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION	45
•	APPENDIX C: NEC DECISION 167/2024 REVOCATION OF PREVIOUS NEC DECISION TO AMALGAMATE NATIONAL ECONOMIC & FISCAL COMMISSION AND DEPARTMENT OF TREASURY	45
•	APPENDIX D: NEC DECISION 168/2024 APPROVAL OF THE INTERGOVERNMENTAL FINANCING ARRANGEMENT REVIEW (IG FAR).....	45

LIST OF FIGURES, GRAPHS, AND TABLES

Figure 1. 2025 Function and Administration Grants Determination (K ‘000).	15
Figure 2. Local-level Government share by Province for 2025 (K’000)	16
Figure 3. 2023 Cost of Service Estimate by Province	19
Figure 4. Actual revenues collected by the province in 2023	21
Figure 5. Fiscal Needs of Provinces for 2025 (Kina ‘000)	23
Figure 6. 2025 Individual Province Share (K’000)	24
Figure 7. Table on Provincial Government’s PGAS – IFMS transition.....	32
Figure 8. Function Grant Warrants Release Trend by Quarters (2018-2023).....	33
Figure 9. Total Function Grant Warrant Release by Years.....	33

Graph 1. Fiscal capacity of Provinces compared to their estimated costs 5

Table 1. Horizontal and Vertical Fiscal Imbalances.....	3
Table 2. How the NNR amount for 2025 was calculated	13
Table 3. Available funding for Provincial and Local-Level Governments	14
Table 4. Minimum Priority Areas and the Performance Indicators.....	29
Table 5. Overall Provincial Sector and LLG Grants released by years.	34
Table 6. List of Target Studies undertaken by the IGFAR TWG in 2024.....	35

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

(2) Without limiting sub-clause (1), a land mediation function grant must be used to fund the operational, training, and supervision costs incurred in the land mediation sector.

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

8 PRIMARY PRODUCT FUNCTION GRANT

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

(2) Without limiting Sub clause (1), a primary production 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.

9 OTHER SERVICES DELIVERY FUNCTION GRANTS

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 8, such as business development, community development, and environment and conservation.

10 ADMINISTRATION GRANT

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

MADE this day of , 2024

Minister for Treasury

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, primary, and secondary education that are within the responsibilities of a Provincial Government, such as:

- (a) The maintenance of schools; and
- (b) The provision 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 LAND MEDIATION FUNCTION GRANT**List of Abbreviations**

BEI	Budget Expenditure Instructions
CoSS	Cost of Services Study
DFAT	Department of Foreign Affairs & Trade
DoT	Department of Treasury
DDA	District Development Authority
DPM	Department of Personal Management
DPLGA	Department of Provincial & Local Level Government
DSIP	District Services Improvement Program
EA	Equalization Amount
GST	Goods & Services Tax
IFMS	Integrated Financial Management System
IGFAR	Intergovernmental Financing Arrangement Review
IRC	Internal Revenue Commission
LLG	Local Level Government
MPA	Minimum Priority Activities
MRA	Mineral Resources Authority
MTDS	Medium-Term Executive Development Strategy
NEC	National Council
NEFC	National Economic & Fiscal Commission
NNR	Net National Revenue
PEFA	Public Expenditure & Financial Accountability
PGAS	Papua New Guinea Government Accounting System
PHA	Provincial Health Authority
PLLSMA	Provincial & Local Level Services Monitoring Authority
PSIP	Provincial Service Improvement Program
RIGFA	Reform of Intergovernmental Financing Arrangement
TFF	Tuition Fee Free
TWG	Technical Working Group

CHAPTER 1: INTRODUCTION

The **Annual Budget Fiscal Report** serves as a critical document prepared by the National Economic & Fiscal Commission (NEFC) to inform the Government, Parliament, and other stakeholders about the allocation of function grants to Provincial and Local Level Governments (LLGs). As mandated by law, this report provides an in-depth analysis of NEFC's operations, the determination of fiscal transfers, and the key achievements in intergovernmental financing for the reporting period.

The preparation and submission of this report comply with the legislative requirements outlined in the **Intergovernmental Relations (Functions and Funding) Act 2009** and the **Organic Law on Provincial & Local Level Governments**. Specifically, **Section 69** of the Intergovernmental Relations Act requires the NEFC to prepare and submit an annual fiscal report on function grants, while **Section 117(9)** of the Organic Law mandates that the **Minister for Treasury** to present the Annual Budget Fiscal Report to Parliament. This report is a key tool for ensuring transparency, accountability, and effective governance in the distribution of fiscal resources to subnational governments.

The primary purpose of this report is to detail the **Function Grant Determinations** for the coming fiscal year, along with an overview of key operational achievements by the NEFC. These determinations are crucial for supporting the fiscal needs of Provincial and Local Level Governments, allowing them to fulfill their responsibilities in delivering essential services to the people. In addition to outlining grant allocations, the report highlights the NEFC's strategic priorities, financial performance, and any reforms or improvements to the intergovernmental financing system. Through this report, the NEFC aims to provide stakeholders with a comprehensive understanding of how function grants are determined, how resources are allocated, and how the NEFC's efforts are contributing to improved service delivery at the local level.

This document also serves as a platform for ongoing discussions about fiscal policy, ensuring that the function grant system remains responsive, equitable, and aligned with the evolving needs of the nation's subnational governments.

APPENDIX B: FUNCTION & ADMINISTRATION GRANTS DETERMINATION



Intergovernmental Relations (Functions and Funding) Act 2009

FUNCTION AND ADMINISTRATION GRANT DETERMINATION

I, **Hon. Ian Ling-Stuckey, CMG, MP, Minister for Treasury**, by virtue of the powers conferred by Section 64 of the **Intergovernmental Relations (Functions and Funding) Act 2009** and all other powers enabling me, in consultation with the National Economic and Fiscal Commission, hereby make the following determination: -

1 AMOUNT OF SERVICE DELIVERY FUNCTION GRANT AND ADMINISTRATION GRANT

Subject to the approval of the Parliament, the amount of each service delivery function grant and administration grant to be made to a Provincial Government is the relevant amount set out in the attached table.

2 SERVICE DELIVERY FUNCTION GRANT

(1) Service delivery function grants are provided to Provincial Governments to ensure that adequate funding is directed towards a minimum set of core services for all people across Papua New Guinea and consistent with the Government's Medium-Term Development Strategy Plan.

(2) Service delivery function grants must not be used to fund salaries or capital development unless the budget allocation specifies that purpose.

3 HEALTH FUNCTION GRANT

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

(2) Without limiting subclause (1), a health function grant must be used to fund goods and services for the following main programs and activities:

- (a) The distribution of medical supplies;
- (b) Outreach patrols;
- (c) Malaria supervision;
- (d) Safe motherhood;
- (e) Immunization;
- (f) Water supply and sanitation;
- (g) Health service monitoring, review, and performance agreements.

APPENDIX A: DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT

DETERMINATION APPORTIONING THE EQUALISATION AMOUNT



Inter-Governmental Relations (Functions & Funding) Act 2009

DETERMINATION APPORTIONING THE EQUALISATION AMOUNT

I, **Hon. Ian Ling-Stuckey, CMG, MP, Minister for Treasury**, by virtual of powers conferred by Section 17 of the *Inter-Governmental Relations (Functions & Funding) Act 2009* and all other powers enabling me, in consultation with the National Economic and Fiscal Commission, hereby make the following determination:

1. LOCAL-LEVEL SHARE.

For a fiscal year, 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 17 per cent of that equalization amount.

2. PROVINCIAL SHARE.

For a fiscal year, the provincial share, being the proportion of the equalization amount of that fiscal year available for distribution amongst Provincial Governments, is the amount remaining after deduction from that equalization amount from the total of the amounts calculated under Clauses 1 for that fiscal year.

3. 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 *Inter-Governmental Relations (Functions & Funding) Act 2009*.

MADE this day of , 2024

Minister for Treasury

1.1 COUNTRY PERSPECTIVE- PAPUA NEW GUINEA (PNG)

Papua New Guinea (PNG), the largest country in the Pacific region, is classified by the World Bank as a lower-middle-income nation. Despite its rich natural resources, PNG's economic indicators, such as Gross Domestic Product (GDP), do not fully reflect the living standards of its citizens. The economy is heavily reliant on the extractive industries (*mining, and petroleum*) which are largely foreign-owned and employ a small percentage of Papua New Guineans. As a result, while GDP figures may show economic growth, it does not capture the real living conditions of most citizens, particularly in rural areas where economic opportunities are limited.

A more accurate reflection of living standards could be obtained through Gross National Income (GNI), which considers income from both domestic and foreign sources. However, the lack of reliable GNI data in PNG limits its usefulness. As an alternative, non-resource GDP (*excluding the mining and petroleum sectors*) provides a clearer picture of the country's economic activity and the well-being of its population.

One of the most significant challenges facing PNG is the accessibility of government services, which are often concentrated in urban areas like the capital, Port Moresby. In contrast, rural and remote regions, where most of the population resides, face significant barriers to accessing basic services. This geographic divide, coupled with inconsistent government service delivery even within urban centers, widens the gap between urban and rural areas.

The complexity of PNG's governance structure further complicates effective service delivery. The country is divided into four main regions: Highlands, Islands, Momase, and Southern, which are further divided into provinces, districts, Local Level Governments (LLGs), and wards. This multi-layered governance structure, while intended to decentralize power, creates challenges in terms of accountability and the equitable distribution of resources. Service delivery is often hindered by inefficiencies, high administrative costs, and a lack of coordination between the national and sub-national levels of government.

In response to these challenges, PNG's intergovernmental financing system was established as part of a broader decentralization agenda. The system seeks to address disparities between provinces, ensuring that resources are allocated more equitably and that service delivery is improved. However, the system operates within a highly centralized framework, with the national government responsible for generating around 95% of the country's total tax revenue. Provincial governments have limited capacity to generate their revenue, and certain tax sources, such as those on beer and cigarettes, are prohibited to avoid duplication with the national Goods and Services Tax (GST) system.

One of the primary goals of the intergovernmental financing system is to address fiscal imbalances that hinder service delivery at the provincial level. There are two key types of imbalances:

Table 1. Horizontal and Vertical Fiscal Imbalances

1. Horizontal Fiscal Imbalances: These refer to disparities in tax revenue and government spending needs between provinces often leading to inequities in service delivery.
2. Vertical Fiscal Imbalances: These occur when provinces cannot generate enough revenue to meet their service delivery responsibilities requiring national support.

The system aims to reduce horizontal imbalances by redistributing resources, while also recognizing that provinces cannot generate sufficient revenue on their own. As a result, the national government collects taxes centrally and provides transfers to the provinces to help fund local services and development.

Beyond addressing fiscal imbalances, the intergovernmental framework also plays a crucial role in coordinating national policies and ensuring that resources are allocated effectively. Over the past decade, several structural changes and government interventions have had a direct impact on the functions and funding of sub-national governments. These interventions are guided by key pieces of legislation, such as:

- The Organic Law on Provincial and Local Level Governments
- The Intergovernmental Relations (Functions & Funding) Act
- The City Authority Act
- The Public Health Authority Act (PHA)
- The District Development Authority (DDA) Act
- The Fiscal Responsibility Act

Together, these laws aim to support more effective governance at the sub-national level and ensure that resources are allocated where they are most needed. Despite these efforts, however, significant challenges remain in improving the overall governance and service delivery across the country. To address these issues, ongoing reforms and reviews of the intergovernmental financing system, including the Intergovernmental Financing Arrangement Review (IGFAR), are essential to creating a more equitable and effective governance structure that meets the needs of all Papua New Guineans.

1.2 THE FISCAL GAP

The determination of Function Grants occurs annually through the application of a legislated formula by the NEFC. This formula carefully considers the respective levels of responsibility held by both national and sub-national governments in delivering services to communities. Notably, variations in cost levels across provinces are attributed to the unique characteristics each province possesses. These discrepancies arise due to factors such as population size and the geographical accessibility of areas within the province.

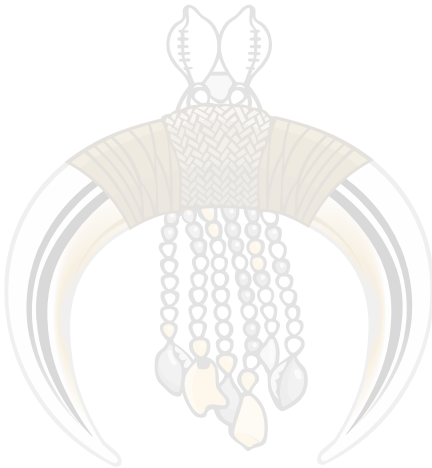
To align with the levels of responsibility and characteristics of provinces, the NEFC conducts a comprehensive costing exercise every five years. This exercise evaluates critical activities undertaken by provinces, ensuring a proportional consideration of their distinct features.

Following the establishment of provincial costs, the national government engages in a review of funding arrangements. However, provincial autonomy in revenue generation is constrained by limitations on the types of taxes they can impose. This limitation is primarily driven by concerns related to duplication, emphasizing the centralized role of the national government in tax-related activities.

The restrictions imposed by the IRC on provincial revenue-raising capabilities create a disparity between the costs associated with delivering government services and the financial resources accessible to provinces for funding those services. This disjunction is commonly referred to as the Fiscal Gap. A visual representation of the fiscal gap for the year 2025 is provided in the graph below for reference and analysis.

CHAPTER 10: APPENDICES:

- APPENDIX A: DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT
- APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION
- APPENDIX C: NEC DECISION 167/2024 REVOCATION OF PREVIOUS NEC DECISION TO AMALGAMATE NATIONAL ECONOMIC & FISCAL COMMISSION AND DEPARTMENT OF TREASURY
- APPENDIX D: NEC DECISION 168/2024 APPROVAL OF THE INTERGOVERNMENTAL FINANCING ARRANGEMENT REVIEW (IGFAR)



the funding that will be required. It will also help ABG as it considers potential partners with the expertise to assist and potential sources of funding to meet the costs that will be involved.

4. On a cautionary note, to derive maximum benefit any such sectoral studies should be grounded in reality to ensure progress can be achieved in the near term.

In addition, and where necessary, project-based costing studies could also be considered, and these may help ABG in estimating the cost of specific projects (e.g., major facilities, roads) and also as it considers the financing requirements.

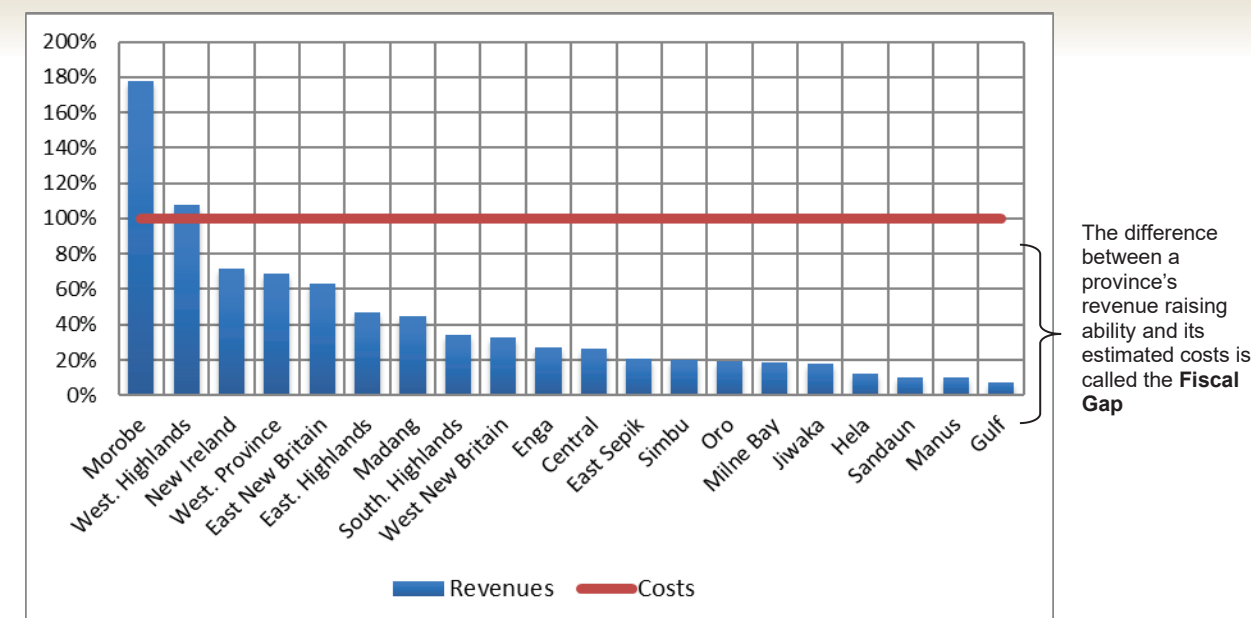
5. **Opportunities for peer learning.** Bougainville's departments can consider using the budgets of the cohort of Pacific Comparators (and other small island states that may be relevant) as a basis for deeper analysis and as information on the detailed costs of functions and activities that may help inform ABG strategy. Further, there are other avenues of assistance, including many international, regional, and bilateral organizations that have expertise in particular functional domains. Examples of these organizations include the World Bank which works across the central administration of government and multiple sectors and the World Health Organization (WHO) with extensive experience in the health sector. There are many others. Regionally, in the Pacific, the CROP agencies – Council of Regional Organizations in the Pacific – have individual mandates and expertise that could be another source of assistance to Bougainville as it moves toward greater autonomy.
6. **Identify and strengthen Bougainville's key accountability mechanisms.** The Autonomous Region of Bougainville appropriates and manages a significant and growing budget. There is an urgent need to identify and strengthen the key accountability mechanisms that safeguard the full Bougainville budget cycle – to ensure its resources are allocated and funds are expended appropriately. The system of accountability should reflect accepted international practice in good governance and PFM. ABG could consider using available tools – including the PEFA review, and governance reviews to understand its existing capacity and what needs to be strengthened. This will have enormous implications for Bougainville domestically and in its engagement with partners.

9.2.5 OTHER OBSERVATIONS

In addition to the recommendations above, the Commission noted the following:

1. The Commission notes that there is an opportunity and need to strengthen aspects of the ABG budget system to better support the transfer of functions, align funding with functions, and promote transparency and accountability. This could be viewed in two parts, being:
 - a) The budget system operating between the National level and AR0B, and
 - b) The internal budget architecture in Bougainville between Buka-regions-community governments.
2. The Commission, in its analysis and research, noted that the level of ABG's internal revenue remains very low as a proportion of its overall budget and of what would be required to support and sustain the drawdown of more functional responsibilities. Put simply, the autonomous region remains very reliant on grants from the national government. Revenue mobilization will be of fundamental importance for Bougainville as it seeks to develop a sustainable platform to support greater autonomy.

Graph 1. Fiscal capacity of Provinces compared to their estimated costs



1.3 REFORMS ON INTERGOVERNMENTAL FINANCIAL ARRANGEMENTS (RIGFA)

The national government's interest in the funding flow to provinces has long been a priority. Before 2009, provinces received funds through a "Kina per Head" system, leading to an unequal distribution where some provinces received a substantial portion of funds while others received less. This resulted in a significant "Fiscal Gap" for several provinces, creating an inequitable distribution of funds.

Provinces with substantial revenue sources, such as mines and other taxable economic activities, received more revenue than necessary for basic service provision. To address this imbalance and adhere to the principle of equal distribution, an Act was necessary. This Act, which aimed at a more comprehensive revenue-sharing arrangement among different levels of government, was passed. The reform of the old system was officially approved by Parliament on July 16, 2008, through the Ordinary Act of 2009.

The reformed system brought about significant changes, particularly in revenue sharing based on a percentage of the government's available resources. The distribution of funds among provinces also transformed. The new formula, now based on the NEFC's cost estimates, determines each province's share of funds. A decade later, the outcome is a notable increase in funding to all provinces, with a particular emphasis on those with lower fiscal capacity.

1.4 TYPES OF GRANTS

Over the last decade, the national government has been providing provinces with three main types of grants, namely:

The staffing grant. Public servant salaries and allowances are funded by the National Government regardless of whether they are provincial or national staff. The single government payroll means that administratively the payments are made directly between the National Government's payroll system and the employee. To maintain budget integrity, each province is provided with a staffing grant that sets out the ceiling that is available for personnel emoluments, and the staffing structure of each province is approved by the Department of Personnel Management (DPM). The management of the staffing grant is highly centralized and is managed by the DPM and the Department of Treasury (DoT).

Development funding. Capital and human development funding is provided through a range of grants. These are projects specific while others are devolved grants provided for a range of activities. The Provincial Services Improvement Program (PSIP) provides each province with K5 million per District. The District Services Improvement Program (DSIP) provided K10 million per District. Guidelines for the use of these funds direct that certain percentages must be allocated into sectors (health, education, infrastructure, etc.) but the specific projects are left to the discretion of decision-making committees in the respective Provinces, Districts, LLGs, and Wards.

Recurrent funding (function and administration grants). To provide basic services, each level of government requires funding for goods and services. These include items such as fuel to undertake patrols or materials for maintenance. The NEFC recognizes that without sufficient recurrent funding, service delivery for rural communities is ineffective. The national government provides a set of *Function Grants* that provide extra recurrent funding to those provinces with the lowest fiscal capacities. It is expected that those provinces with high internal revenues can fund a larger portion of their recurrent costs.

Recurrent funding was the focus of RIGFA and is the main concern of the NEFC. Chapters 2 to 5 of this report outline the process for determining the Function Grants and the amounts for 2025.

1.5 ROLE OF THE NEFC

The NEFC serves as an advisory body to the government, specifically addressing intergovernmental financing matters within Papua New Guinea. Its primary function is to provide recommendations regarding the allocation of function grants among the Provinces and LLGs. The subsequent distribution of these function grants is determined by the Treasurer, who relies on the advice furnished by the NEFC.

From a technical standpoint, the NEFC engages in a comprehensive analysis to grasp the cost pressures experienced by each province and assess their respective self-generated revenues. Employing a legislatively defined formula, the NEFC meticulously computes the share entitled to each province and LLG. This calculation is guided by a set of principles, which are elucidated in Chapter 4, detailing the procedural intricacies of how the NEFC allocates Function Grants.

It is also important to note that the Pacific cohort each receives funding from development partners that are then targeted to various initiatives – projects, activities, and capacity development – across sectors. This funding is significant, and in broad terms, the Pacific cohort receives circa 40% or more in cash grants and aid in-kind from donors. There may also be other funding received from development partners that are not recorded in the annual budgets of the Pacific cohort. While we note the presence and importance of this funding from DPs, it is not included in the amounts of the Pacific cohort.

9.2.4 THE KEY RECOMMENDATIONS

In response to the TOR, the NEFC has taken a ‘whole of government’ view and approach to the study and has supplemented this with focused analysis in particular (but not all) functional areas and sectors. The intent is to provide information that can assist and contribute to the discourse on the direction the cost of public administration may take in coming years as more functions are transferred from Waigani to Bougainville.

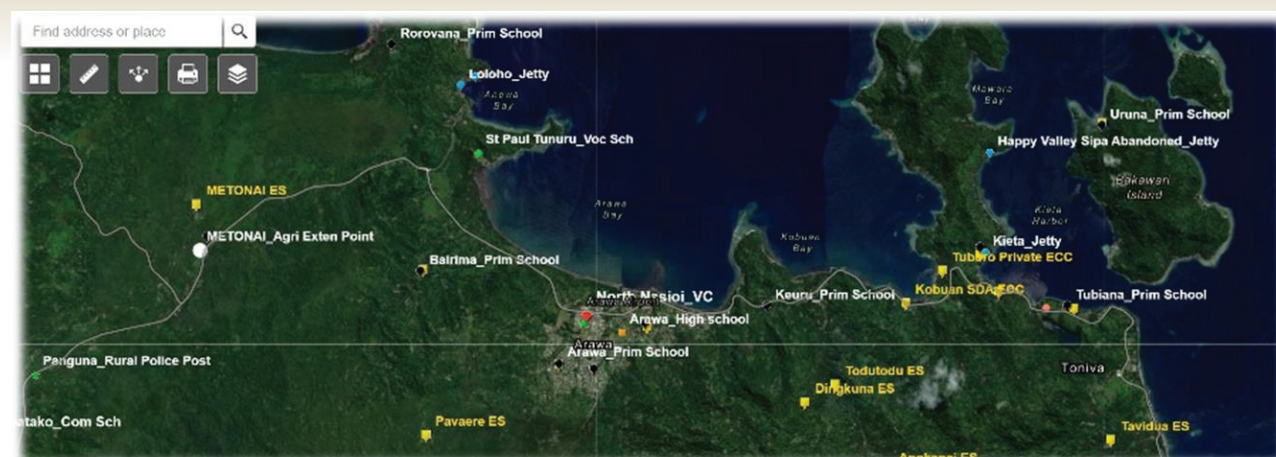
In summary, the Bougainville administration may want to consider the following suggestions as it seeks to progress the transfer of responsibilities and achieve greater autonomy.

Recommendations for consideration

1. *Develop a workable methodology to support function-transfer.*
2. *Build on the functional analysis and responsibility specification exercise that has taken place.*
3. *Consider, where appropriate, adopting additional strategies to gather insight into possible costs.*
4. *Make the most of opportunities for peer-learning.*
5. *Identify and strengthen Bougainville’s key accountability mechanisms*

These areas are discussed below.

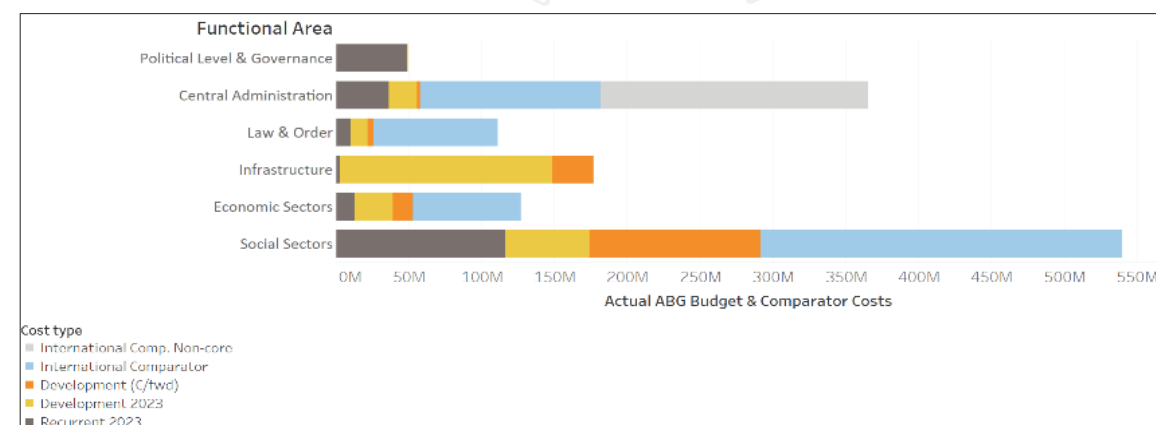
1. ***Develop a workable methodology to support the transfer of functions.*** The ABG has amassed considerable experience in working through the many challenges involved in migrating, implementing, and integrating new and expanded functions from GoPNG to its administration. We would encourage ABG to harness and share this experience across its administration and departments. The key is to identify a methodology that works well, is practical, and encourages progress.
2. ***Build on the functional analysis and responsibility specification exercise.*** The ABG may see merit in using the functional responsibility matrixes to help guide its ongoing planning processes and to help inform the consultations between stakeholders. The matrixes should be viewed as an initial draft only and can be modified by ABG and developed to reflect the setting in Bougainville more fully. Additional information can be added – on responsibilities and costs – when they come to light through ABG’s ongoing consultations with national agencies and its own efforts to plan and cost in individual sectors.
3. ***Consider additional strategies to gather insight into possible costs.*** The ABG should consider the use of sector-based costing studies (e.g., in health and education) as it strategizes and develops its short to medium-term plans. This sector-level planning process is critical as Bougainville considers how to best integrate new functional responsibilities and



Cost saving & efficiency: There may be opportunities for cost saving. One example relates to the rate of per diems used for duty travel. Duty travel is a critical and core aspect of service delivery and public administration in Bougainville. Staff in many sectors need to travel for their day-to-day work activities – health staff need to conduct outreach to deliver immunization and other services; education inspectors need to visit schools to provide support and promote accountability; police need to respond with urgency to emergencies in urban and rural areas; staff in primary industries need to support local projects. With travel so frequent, the rates of per diem need to be set at sustainable levels.

Adequacy of funding: Some service sectors may need additional operational funding to support them in their service delivery responsibilities. Health is an example, the NEFC cost estimates suggest the health sector – particularly health facilities – may need additional operational funding to ensure Bougainville’s health facilities are stocked with basic equipment & medicines, hygienic & maintained, have fresh water and toilets, and have funding to support outreach.

A review of the budgets of a cohort of three small states in the Pacific region provides an indication of the costs of public administration and service provision in settings that are somewhat similar. We note, however, that these are the budgeted costs of small states with relatively settled budgets – whereas Bougainville is on a journey toward greater autonomy and, as such, the costs are likely to vary before eventually settling.



Overall, the average of the Pacific cohort (with adjustment for population) records budgets that are two times higher than the overall ABG Budget in 2023 (for recurrent and development appropriations). However, when viewed by functional groups, and individual sectors, the difference between the average of the Pacific cohort and the relevant ABG budget for the functional group/sectors varies. Some functional groups, like Law & Justice, show a greater gap while for others the gap may be lower. This variation is not surprising and reflects a range of factors that are discussed in the body of this report.

CHAPTER 2: KEY ACHIEVEMENTS OF THE NEFC IN 2024

2.1 OPERATIONAL HIGHLIGHTS

In the fiscal year 2024, the National Economic and Fiscal Commission (NEFC) achieved significant milestones that reflect its ongoing commitment to improving the country’s fiscal policy framework, intergovernmental relations, and economic governance. A key operational highlight was the successful resolution of the long-standing issue regarding the potential amalgamation of NEFC with the Department of Treasury.

In 2012, as part of a broader public sector reform initiative, the National Executive Council (NEC) tasked the Public Sector Organization Reform Team (PSORT) with assessing the functions of government institutions, including NEFC and Treasury, to identify areas where cost-saving measures could be implemented. As per NEC Decision NG: 113/2012, the budget for NEFC and Treasury was initially proposed to be merged. This reform was designed to streamline operations and control overruns in the Personnel Emoluments Budget.

Further directives followed in the coming years, including NEC Decision NG: 303/2015, which recommended co-locating NEFC and the Department of Treasury (DoT) to promote operational efficiencies. Acting on this, Treasury Secretary, Mr. Vele, instructed the NEFC to explore co-location, believing that working side-by-side with the DoT would generate efficiencies in shared programs and initiatives. However, this proposal triggered a need for legal clarifications, leading NEFC to seek legal advice from Kamutas Lawyers in 2013.

In 2017, NEFC sought clarification from the State Solicitor regarding the constitutional basis for its existence, particularly in light of a 2018 NEC directive (NEC Decision 15/2018) that proposed amalgamating NEFC with Treasury. A legal opinion issued by the State Solicitor in March 2020 suggested that while the Organic Law on Provincial Governments and Local-level Governments (OLPGLLG) does not recognize NEFC as a constitutional body, it also indicated that legislative amendments would be needed to give NEFC constitutional status.

Despite these discussions, NEFC remained steadfast in its belief that maintaining its independence was essential for fulfilling its advisory role in intergovernmental financing and fiscal transfers. The core mission of NEFC, particularly concerning advising on Provincial Function Grants and conducting the ongoing Intergovernmental Financing Arrangement Review (IGFAR), required the Commission to function autonomously from the Treasury.

In 2024, NEFC’s advocacy efforts culminated in the successful revocation of the NEC Decision to amalgamate NEFC with Treasury. NEC Decision No. 167/2024 (Appendix C) formally revoked the previous decision, ensuring NEFC’s continued existence as a separate entity. This decision aligns with the strategic direction outlined in the IGFAR and secures NEFC’s independence, allowing it to continue providing critical, unbiased recommendations to the National Executive Council on fiscal decentralization and intergovernmental finance issues.

2.2 THE CREATION OF THE MINISTRY OF RURAL AND ECONOMIC DEVELOPMENT: A NEW CHAPTER FOR NEFC

In 2023, the Marape-Rosso government established the Ministry of Rural and Economic Development, signaling a bold step towards addressing Papua New Guinea's (PNG) economic and rural development challenges. With Hon. Joseph Lelang appointed as the inaugural Minister, the Ministry is tasked with overseeing six key agencies, including the National Economic & Fiscal Commission (NEFC), each playing a crucial role in shaping the nation's fiscal and economic landscape.

The NEFC's inclusion in the Ministry marks a significant transition in its operational focus. Known for its expertise in intergovernmental financing, the NEFC advises on fiscal policy and ensures fair distribution of national revenues to provinces and local-level governments. While the Commission's core function of promoting equitable resource allocation remains unchanged, being part of this new Ministry positions it to contribute more directly to broader rural and economic development goals.

In addition to the NEFC, the Ministry oversees five other agencies:

1. Independent Consumer and Competition Commission (ICCC): Focused on market fairness, consumer protection, and promoting competitive practices.
2. Department of Implementation and Rural Development (DIRD): Responsible for rolling out government projects funded through the Service Improvement Program (SIP).
3. Sovereign Wealth Fund (SWF): Manages resource-based revenues, ensuring long-term economic stability and wealth preservation.
4. Superannuation: Oversees retirement funds, boosting national savings and providing financial security for citizens.
5. Savings and Loans: Promotes financial inclusion by offering accessible savings and credit options, particularly for rural communities.

2.3 SYSTEM REFORMS

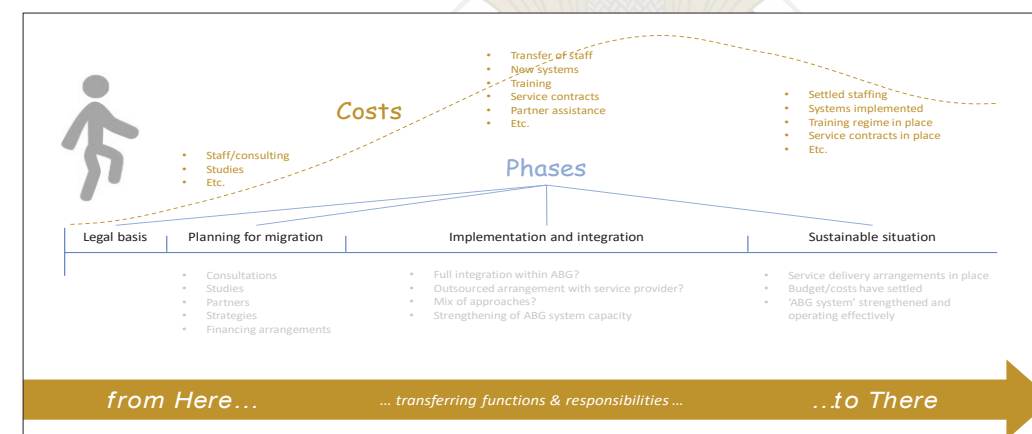
As part of its strategic reforms, the NEFC was at the forefront of the ongoing review of the current intergovernmental financing arrangements in Papua New Guinea. Over the years, NEFC has consistently worked to improve the efficiency, fairness, and transparency of fiscal transfers between national and subnational governments. A major system reform in 2024 was completing the Intergovernmental Financing Arrangement Review (IGFAR) consultations, which involved collaboration with various agencies, key line departments, other key stakeholders, and the sub-national administrations.

The IGFAR was a significant undertaking designed to evaluate the existing fiscal transfer systems and propose a more efficient and equitable allocation of funds to provincial and local-level governments. NEFC's role in this process was crucial, as the Commission was tasked with providing independent analysis and advice, free from potential conflicts of interest, particularly in light of the ongoing discussions around the merger with Treasury. The results of this review were used to inform policy decisions presented to the National Executive Council (NEC) that are intended to shape the future direction of intergovernmental financing in Papua New Guinea.

Indeed, one of the challenges in understanding the costs of government administration and services in Bougainville is the reality that only some of the costs are visible to ABG and other stakeholders, while many other significant costs are unseen. The iceberg (see illustration below) illustrates the problem, with some costs above the waterline and visible while other costs are below the water and unseen. Using this depiction, the ABG annual budget is visible and above the waterline. In contrast, a second category is the unseen costs related to Bougainville that are buried within the budget of individual GoPNG agencies like the national departments of health and education. A third category of costs is the unseen costs of the wider GoPNG system. Bougainville benefits in many ways from the wider GoPNG system – examples include civil aviation, meteorological services, specialist policing services, and the many connections these agencies have with international organizations – the costs of these system benefits are highly significant but understandably they are rarely considered.

In addition to costs relating to particular sectoral responsibilities, in a broader sense Bougainville will need to strengthen and expand its administrative and service capacity to perform at the level 'greater autonomy' will require. The combined cost of 'transferred functions' and a 'strengthened expanded administrative mechanism' will be significant.

While the journey toward greater autonomy is uncertain, it is reasonable to assume that the cost of public administration and service provision will rise as Bougainville starts to meet the costs that are currently within the budgets of national agencies. This will likely involve a migration of costs from national agencies in the GoPNG budget to the ABG Budget. The trajectory of this migration – i.e., timing and amounts – are uncertain, yet will reflect different phases as Bougainville's budget moves through phases of transfer and integration, toward an ultimate state of a maturing and sustainable budget position.



An analysis of the current ABG Budget in 2023 shows an overall budget appropriation of K654.3 million. This comprises K232.6 million recurrent budget (55% payroll and 45% goods and services) and K421.7 million in development budget (including items that are variously capital investment, projects, and recurrent in makeup). Further, the development budget of K421.7 million includes development newly appropriated in 2023 (62%) and development carried over from 2021/22 (38%).

The detailed cost modeling completed by the NEFC of the recurrent operational budget suggests a review of the current budget against the NEFC estimates may assist ABG in strengthening the budget. This will assist ABG in its efforts to achieve cost savings and efficiency and to ensure service-facing departments are adequately funded to fulfill their mandates.

9.2.2 THE SITUATION

Factors including land mass, population density, and remoteness are important in shaping the challenge for all governments in providing an effective administration and system of service delivery. Providing services and administration to large urban populations is very different from providing administration and services to largely widespread rural communities. For ABG, which serves a largely rural and maritime population spread across several islands and involves travel on open seas, its public administrative and delivery systems need to reflect the geography of its communities. These factors matter.

In considering the cost of government administration and service delivery in Bougainville it is useful to begin by situating and contrasting the operating environment in Bougainville today – including aspects such as geography, remoteness, infrastructure, utilities, services, and human resources – to the operating environment in other provinces in Papua New Guinea which have similarity and relevance. For this purpose, we selected a cohort of four provinces all with populations in a similar range – East and West New Britain, Milne Bay, and Simbu – and a sample of indicators to provide a snapshot and act as a reference point to provide context.

The details are outlined in the introduction to this report, but in summary, we can see that when compared to the cohort of provinces, Bougainville has made notable progress in reinstating and rehabilitating aspects of its infrastructure, services, and human capacity over recent years. This capability is of course foundational to Bougainville and the base from which it will continue to build and develop. However, the picture is mixed, with some of Bougainville's indicators below the provincial cohort (e.g., some health indicators and sanitation fall in this category), and other indicators comparable to the provincial cohort (e.g., some education-related indicators are in this category).

9.2.3 THE KEY FINDINGS

While Bougainville has made progress in its journey to adopt and integrate new functions and responsibilities within its system, there is much more to be done. Many responsibilities, and their related costs, remain at the national level within many national agencies. While some of these costs can be discreetly identified, many cannot.



A key reform outcome from this review was the policy recommendation to rescind the decision to amalgamate NEFC and Treasury, ensuring that NEFC could continue its vital role in advising the NEC on fiscal decentralization, intergovernmental transfers, and the equitable distribution of resources across the country. This recommendation was presented to the Minister responsible and was formally endorsed by NEC Decision 167/2024 in July 2024 (Appendix C).

In its meeting No.13/2024, the NEC also resolved to formally endorse the Intergovernmental Financing Arrangement Review (IGFAR), recognizing its critical importance in shaping the future of fiscal transfers and intergovernmental relations in Papua New Guinea. This endorsement was captured in NEC Decision 168/2024 (Appendix D), which acknowledged the comprehensive work carried out by NEFC and its partners in reviewing the existing financing arrangements. The endorsement of the IGFAR marks a significant step forward in the government's efforts to improve the equity and effectiveness of fiscal transfers to subnational governments, reinforcing NEFC's role as the independent body responsible for advising on these critical matters.

The NEFC's achievements in these legal and policy reforms in 2024 highlight its resilience and commitment to improving public sector efficiency, ensuring the continuity of its independent role in advising on fiscal policy, and strengthening the country's intergovernmental financing arrangements.

CHAPTER 3: ANNUAL BUDGET CYCLE

The government budget in Papua New Guinea (PNG) is a key tool for managing the country's finances. It is a clear plan showing the expected income and spending for the coming fiscal year. The determination of the budget is important for deciding how public money is distributed among different sectors and programs. The budget reveals the government's priorities and aims to support economic growth, improve public services, and meet the various needs of citizens nationwide. For the benefit of the reader, the budget comprises several key components that work together to provide a comprehensive picture:

3.1 REVENUE ESTIMATES

The revenue estimates section outlines the expected income from a variety of sources, such as taxes, royalties from natural resources, and grants from both local and international partners. This projection is vital because it informs the government about how much money it can anticipate receiving, which in turn shapes its spending plans. By carefully estimating revenue, the government can make informed decisions about funding levels for different programs and services, ensuring that it can meet its financial commitments.

3.2 EXPENDITURE PLANS

The expenditure plans detail how the government intends to allocate its funds. This section includes specific funding amounts for crucial areas such as health, education, infrastructure development, and law and order. Each of these sectors plays a vital role in the country's development and directly affects the lives of citizens. The primary goal of the expenditure plans is to ensure that essential services are delivered effectively and efficiently, providing support where it is most needed and improving the quality of life for all citizens.

3.3 DEFICIT OR SURPLUS

Another critical component of the budget is the indication of whether the government expects to run a deficit or a surplus. A deficit occurs when the government plans to spend more than it earns, while a surplus means that it expects to collect more than it spends. Managing these figures is crucial for maintaining financial stability and ensuring that the government can meet its obligations without overextending its resources. A balanced budget helps build confidence among investors and citizens, contributing to a stable economic environment.

3.4 LINKING THE BUDGET TO LOCAL GOVERNANCE

The national budget has a direct impact on the work of the NEFC. As the national budget outlines the available financial resources, the NEFC utilizes this information to develop its recommendations for provincial (and local-level governments) functions and administration grants. This close connection guarantees that sub-national administrations receive the necessary funding support to implement programs and services that align with the broader national priorities. By ensuring that sub-national administrations have adequate funding, the government can enhance the effectiveness of service delivery across the country.

Furthermore, by adhering to the guidelines established in the Intergovernmental Relations (Functions and Funding) Act, the NEFC promotes accountability and transparency in how funds are allocated and utilized at the provincial level using strict timeframes that are aligned to the budget process.

Outlined below is the budget cycle that the NEFC uses to comply with the budgetary process:

31st March

- NEFC calculates the **equalization amount** (currently based on 6.57% of NNR) using data from the Final Budget Outcome (FBO) and
 - Advise the Secretary for Treasury of the total equalization amount and
 - Advise the Minister of the suggested split between PGs and LLGs.
- Treasury advises NEFC if they want to increase the **equalization amount**.

Should the NNR percentage change?

- Minister in consultation with NEFC determines how the **equalization amount** is **appointed** between provinces and LLGs through a Ministerial Determination.

30th April

These amounts will be fixed.

- NEFC gathers data on estimated provincial revenues, Own-source revenues, GST and Royalties and Dividends, and estimated costs
- Does the calculation of each **individual province share** and each **individual local-level share**
- NEFC advises Treasury through a Budget Advice of each **individual province share** and each **individual local-level share**

Equally critical is the approach, how the NEFC will go about implementing the anti-corruption strategy and it will be action-driven and conducted through several initiatives and specific measures.

9.1.2 STRATEGIC INITIATIVES AND MEASURES

The NEFC will provide quality independent and objective advice on economic and public policy issues to the government in promoting anti-corruption. Making sure fiscal information is available to the public in an accurate, comprehensive, and timely manner throughout the budget cycle. Develop a subnational Chart of Accounts in compliance with PFMA and make recommendations of function grants in compliance with all government legislation, regulations, acts, and laws. Promote anti-corruption through annual regional workshops at sub-national levels and embed anti-corruption in the NEFC's business culture and quarterly PLLSMA Committee meetings and Annual Regional Workshops. Build awareness for compliance with the NEFC's 'zero-tolerance' policy on bribery and corruption through quarterly meetings with key partner agencies' conferences, and training programs.

In conclusion, corruption is prevalent in the country and the NEFC is encouraging intergovernmental agencies to play a pivotal role in driving the anti-corruption strategy with passion, leadership, and ownership from everyone. That, there is an amiable and conducive working environment and communication strategies engagement within the intergovernmental financing arranging system. The objective is to establish corruption-free service delivery and foster a brand of reform intergovernmental financing business culture. The NEFC is committed to ensuring that the anti-corruption strategy is collaboratively addressed in a nationwide approach from everyone to minimize corruption for greater satisfaction of service delivery.

9.2 AUTONOMOUS BOUGAINVILLE GOVERNMENT (ABG) COST OF SERVICES STUDY

In 2023, the National Economic & Fiscal Commission in partnership with the Department of Prime Minister National Executive Council, and the Department of Treasury, worked in collaboration with the Autonomous Bougainville Government to conduct a costing exercise to better understand the cost of government administration and services in Bougainville.

This draft report – '*From Here, To There*' – contains the preliminary findings from the study led by the NEFC and the wider exercise that it has conducted in response to the request from the ABG and the Department of Prime Minister & NEC. The draft report is intended to be the basis for consultations and discussions with the ABG and with the partner agencies involved in this exercise.

9.2.1 WHAT ARE THE KEY USES OF THIS REPORT?

The draft report has several related parts and provides information on multiple layers of detail. It is envisaged that the draft report, together with other information at hand, may assist in a variety of areas.

- Information to assist the continuing discussions between ABG and GoPNG.
- Additional information for ABG, as it continues to strengthen its budget progresses the work in the transfer of responsibilities and considers the financial implications.
- Recommendations for ABG, in how it may build further on its understanding of the current and potential costs of government administration and service delivery concerning the transfer of responsibilities.

9.1.1 SECTION 187H OF THE CONSTITUTION SETS OUT THE ENABLING LEGISLATION

The NEFC is established under section 187H of the Constitution and its detailed roles and responsibilities are further specified under the following legislation:

1. Organic Law on Provincial & Local Level Governments (OLPLLG) 1998- Section 117.
2. Intergovernmental Relations (Functions & Function) Act 2009 (IGRFF); and
3. National Economic & Fiscal Commission Act 2009.

And other relevant and related legislations of other line agencies, sub-national governments, authorities, and statutory bodies. Hence, the anti-corruption strategy is developed around the enabling legislation to ensure its primary objectives of the strategy is achieved through the four key focus areas described below.

The four (4) key focus areas for the NEFC to achieve the anti-corruption strategy are:

1. Strengthening and mainstreaming intergovernmental funding arrangements.

This is to ensure that strengthening and mainstreaming intergovernmental financing arrangements will be channeled through the mechanisms of analyzing and monitoring the function grants to be transparently processed and that the decisions around the intergovernmental funding arrangements are free from corruption and from being biased. This enables the Commission to realize the National Government's vision and enabling laws and policies for increasing funding to sub-national levels yearly and for promoting integrity and accountability of service delivery.

2. Ensuring accountability, transparency, and compliance.

The NEFC is supportive of a strong accountable, transparent, and compliance process focused on setting the foundation for the performance of the Commission in supporting an intergovernmental financing system that is responsible for the budgetary and resourcing requirements and meeting the expectations for the subnational levels of government. Such practices encourage all-encompassing judgments and choices based on fairness, justice, equality, ethical values/principles, and professionalism.

3. Promoting effective anti-corruption leadership and practices; and

The NEFC promotes effective anti-corruption leadership and practices required for building healthy and amiable working relationships, based on corporate business values amid every staff of NEFC, all people and entities from across the government, the private sector, and civil society in which we engage. The NEFC also influences our external partners through role-modeling, agenda-setting, and promoting anti-corruption leadership and practices in a variety of forums.

4. Fostering anti-corruption culture.

The NEFC will strengthen its anti-corruption culture by sensationalizing corrupt and dishonest practices and promoting and holding people responsible to a professional level of conduct, in maintaining codes of conduct and ethical values of leadership. Creating and keeping a corruption-free culture that will ensure quick detection of inadequacies in funding arrangements and boost public trust through enhanced service delivery.

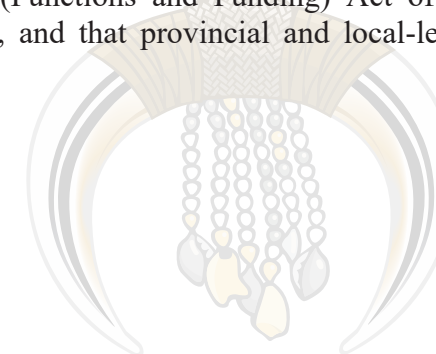
31st May

- NEFC advises the Minister responsible through a Budget Advice for the Minister to endorse through a Ministerial Determination.
- Treasury advises Provincial Governments and LLGs of **individual province share and local-level shares**

November (Budget Lock-Up Session)

- NEFC provides a copy of the **Annual Budget Fiscal Report** to the Minister for Treasury.
- NEC approves **service delivery function grants** for each provincial government and local-level government in the annual budget Volume 2 part 2. Other revenues are shown in the Volume 1 table and Volume 2 table.

The general budget overview of the Government of Papua New Guinea highlights the critical importance of effective financial management in promoting the country's development. The NEFC's role in determining annual provincial function and administration grants, as outlined in the Intergovernmental Relations (Functions and Funding) Act of 2009, is vital for ensuring that resources are allocated fairly, and that provincial and local-level governments can fulfill their responsibilities.



CHAPTER 4: THE EQUALIZATION AMOUNT

Each year, provinces anticipate a set minimum funding, known as the "Equalization" amount, as part of the Function & Administration Grants. This funding pool, outlined in Section 19 of the Intergovernmental Relations (Functions and Funding) Act 2009, is subsequently distributed among individual provinces and Local Level Governments (LLGs). In the upcoming 2025 Budget, the calculated Equalization amount stands at **K847.5 million**, with detailed calculations provided on page 11.

Since the transitional period, a fixed prescribed percentage of 6.57% of the Net National Revenues (NNR) has dictated the funding allocation. Consequently, the available funds for provincial and local level governments fluctuate in proportion to the NNR relative to this prescribed percentage. The NNR represents the national government's total tax revenue, excluding income from mining and petroleum taxes. The Reform on Intergovernmental Financing Arrangement (RIGFA) underscores the importance of fair revenue-sharing arrangements between the national government and provincial and local level governments. In essence, higher NNR in a given year results in increased funding for provincial governments and LLGs, while lower NNR leads to reduced funding for these entities.

4.1 CALCULATION OF THE EQUALIZATION AMOUNT- 2025

The Equalization Amount, a pivotal aspect outlined by the Intergovernmental Relations (Functions and Funding) Act 2009, follows a defined formula. This amount serves as the funding pool earmarked for fair distribution among provincial and local level governments. To derive the Net National Revenue (NNR), concrete data from the second fiscal year prior is employed. In the case of the 2025 calculation, the Treasury Department's 2023 Final Budget Outcome, typically disclosed on or before March 31st, was utilized.

A preliminary assessment of the equalization amount for the upcoming fiscal year is submitted to the Secretary for Treasury by **March 31st**. The Secretary holds the authority to augment this sum. According to the Act, the Secretary of the Treasury is mandated to communicate the revised estimate to the National Economic & Fiscal Commission (NEFC) on or before April 30th of the same year. It is crucial to note that this 'equalization amount' estimate represents a baseline, capable only of being increased, not diminished.

The following formula illustrates section 19 of the Act.

General tax revenue for 2023	-	Mining and petroleum tax revenue for 2023	=	Net National Revenue
---	----------	--	----------	---------------------------------

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) Any other tax imposed concerning any gas, mining, or petroleum activity.

Being highly volatile in nature, the Mining and Petroleum Tax Revenue is usually excluded to maintain stability in the province's pool of funding and stabilize the amount of funding to Provinces and local-level governments.

CHAPTER 9: ASSISTING THE REFORM PROCESSES

9.1 ANTI-CORRUPTION- AN INTEGRAL STRATEGIC COMPONENT FOR IGFA

Promoting anti-corruption is a global agenda, it is everyone's responsibility. The Transparency International PNG empowers every organization and citizen to promote anti-corruption. The NEFC is no exception in partnering with Transparency International PNG developed Anti-Corruption and Integrity Strategy 2022-2025, to speak against corruption, especially considering the abuse of power entrusted to people in power for personal gain.

The Intergovernmental Financing Arrangement Review (IGFAR) discovered that the existing financial transfers from the National Government to the Sub-National Government as per the Intergovernmental Relations (Funding & Function) Act 2009 remain fragmented with functional overlaps, duplications, and policy misalignments. Hence, the NEFC is committed to seeing that anti-corruption becomes an integral strategic component for every level of government to improve fragmentation and disintegration and streamline intergovernmental financing arrangements. There must be amiable cooperation and coordination from every level of the government to perform their work in a transparent and accountable manner.

The National Economic and Fiscal Commission in partnership with Transparency International PNG in developing the Anti-Corruption Strategy confirms that corruption is a gigantic impediment in the country's public service system thus affecting effective service delivery across PNG.

The NEFC remains committed to fighting corruption and is adamant about building a culture that demonstrates a high standard of honesty and integrity in the three tiers of government, especially in the public service. Though it is not an easy task, the NEFC being a partner is committed to advocating for minimizing corruption-free work culture. Thus, the Commission acknowledges that it causes a real drawback in positive service delivery when embarking on and trying to minimize corrupt practices. Corruption will always remain and has permeated all the systems in our country, the NEFC's long-term strategy is to minimize by building the right anti-corruption business culture and installing appropriate and effective intergovernmental financing arrangement systems to prevent corrupt practices from occurring.

The NEFC's key focus is to build a work culture that promotes a high level of professionalism, honesty, and integrity, and at the same time review and implement effective systems to minimize and prevent corrupt practices and conduct from happening throughout the intergovernmental financial arrangements process.

Corrupt activities and behaviors are executed by people who control or have power in making decisions, as well as guardians of those who have access to public resources and systems. Therefore, the NEFC is mindful of the repercussions and is taking effective initiatives to build the right culture to reform people's behavior and demeanors, to be honest, and to perform with integrity that will have a sustainable positive impact in minimizing and preventing corrupt practices.

The strategy to approach has both internal and external outlooks. Firstly, the NEFC will implement the anti-corruption strategy within its operational activities. Secondly, the NEFC will be working with the key agencies and partners in implementing this strategy through some of its key programs and activities through defined initiatives, success measures, and expected outcomes in line with the enabling laws.

As part of the ongoing reforms, the Department of Provincial and Local Level Government Affairs is progressing with the Function Assignment Determination to ensure that roles and responsibilities at the sub-national level are clearly defined and better aligned with available funding. Additionally, the National Economic and Fiscal Commission (NEFC) has been working on advancing submissions related to the Net National Revenue (NNR), intending to make funding for sub-national governments more equitable. These efforts aim to ensure that resources are more evenly distributed, addressing the disparities between urban and rural areas and improving service delivery across the country.

The outcome of the 2024 IGFAR activities, including the studies and consultations, provides a strong foundation for future reforms in PNG’s intergovernmental financing space. By addressing both administrative and financial inefficiencies, the aim is to create a more transparent, equitable, and effective system that can better meet the needs of all Papua New Guineans, particularly those in remote and underserved areas.

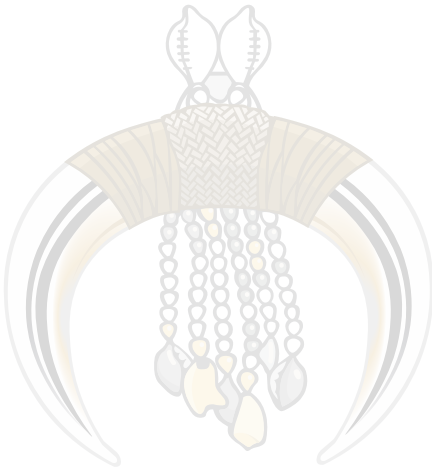


Table 2. How the NNR amount for 2025 was calculated

Act Definition	Final Budget Outcome equivalents	2022	2023	Difference
Total Tax Revenue	Tax revenue	15, 776.2 million	16, 806.3 million	1,030.9 million
Mining and petroleum tax revenue	Mining and petroleum taxes	4, 036.1 million	3, 906.5 million	(129.6) million
EQUALS (=)				
		2024 Budget	2025 Budget	Difference
Net National Revenue Amount		11, 740.1 million	12, 899.8 million	1, 159.7million
Equalization Amount		771.3 million	847.5 million	76.2 million

For the 2025 Budget, the minimum funding level for the equalization amount is calculated according to the following formula in Kina million:

Net national revenue for 2023

X

6.57%

=

NEFC estimate of 2025 equalization amount

K 12,899,800

x

6.57%

=

K847, 516, 860

The total amount for 2025 (K million) has increased by **K76.2 million** higher than the 2025 total funding amount (**K771.3 million**). The increase is primarily due to high total tax revenue collections in 2023 compared to 2022. Given the increase in the 2025 total funding, most provinces’ funding is expected to have some significant increases.

4.2 APPORTIONING THE EQUALIZATION AMOUNT BETWEEN PROVINCIAL AND LOCAL-LEVEL GOVERNMENTS

Equalization Amount

The Ministerial Determination that was issued by the Treasurer splits the equalization amount of **K847.5 million** as follows.

Local Level Share

The Local-level share is the proportion of the equalization amount to be distributed amongst all rural and urban LLGs. As stated in the Ministerial Determination, the share is about 17% of the 2025 Equalization Amount. Overall, for the 2025 Budget, LLGs will receive funding of **K144.1 million**.

Provincial Share

The provincial share is the amount remaining after deductions are made from the local level share on the Equalization Amount. The share will be distributed amongst all provinces through Function and Administration Grants.

Table 3. Available funding for Provincial and Local-Level Governments

Available funding for Provincial Governments from Ministerial Determination		
2025 Equalization Amount	K771.3 million	100.00%
<i>(Less) LLG Share</i>	<i>K144.1 million</i>	<i>17%</i>
<i>Provincial Share</i>	<i>K703.4 million</i>	<i>83%</i>

As shown in the table above, for the 2025 Budget, provinces will receive a total funding of **K703.4 million**.

The two components are funded from the equalization amount (EA) and distributed based on need.

4.3 CHAPTER FOUR: RECOMMENDATIONS

Recommendations for allocating function and administration grants to Provinces and LLGs are communicated annually to the Treasurer through the Ministerial Determination by the end of May. These recommendations, specifically for provinces, are broken down based on distinct service delivery function grants, such as those for health or infrastructure maintenance. Provinces have some flexibility within their overall sectoral ceiling, allowing them to propose minor adjustments among function grants. The NEFC imposes a maximum shift limit of 10%. When provinces seek changes, negotiations typically take place between the Treasury and NEFC to reach an agreement on the revised distribution among function grants.

The Treasurer is then advised of this shift through a negotiated recommendation from both the NEFC and Treasury. If accepted, the Treasurer then determines to formalize the splits amongst the provincial grants for the coming year's fiscal budget.

This chapter elaborates on the outcomes derived from the NEFC's formula. Subsequent chapters provide a detailed overview of the steps involved in the NEFC's calculation of distribution, including the pertinent data used in the process.

CHAPTER 8: INTERGOVERNMENTAL FINANCING ARRANGEMENT REVIEW (IGFAR)

In 2024, significant strides were made in reviewing and improving Papua New Guinea's (PNG) intergovernmental financing system through the ongoing Intergovernmental Financing Arrangement Review (IGFAR). Since the introduction of the Intergovernmental Relations (Functions and Funding) Act in 2009, the goal has been to improve the distribution of resources between national, provincial, and local-level governments to enhance fiscal decentralization. However, challenges such as uneven resource allocation, issues with cash releases, and governance inefficiencies have hindered the effectiveness of this system, particularly in rural and remote areas.

The IGFAR process in 2024 was designed to address these issues by conducting a comprehensive review of the current financial arrangements and exploring opportunities for reform. This review focused on improving the equity, efficiency, and accountability of the system, ensuring that funding reaches the local level where it is needed most. Key activities during the year included a series of National Agency Consultations, which brought together a wide range of government stakeholders. These consultations played a vital role in shaping the review and identifying specific areas for reform.

The consultations were complemented by several key target studies aimed at better understanding the needs of sub-national administrations. These studies covered various important aspects of the intergovernmental financing framework, including:

1. <i>Review of the Goods and Services Tax (GST) Sharing Arrangement</i>
2. <i>Review of Non-Tax Revenue Arrangements</i>
3. <i>Review of Carbon Tax Arrangements</i>
4. <i>Sub-national Borrowing</i>
5. <i>Governance and Funding Arrangements for Local-level Governments (LLGs)</i>
6. <i>Review of District Development Authorities (DDAs)</i>
7. <i>Review of City Authorities</i>
8. <i>Review of Provincial Health Authorities (PHAs)</i>
9. <i>Review of Special Purpose Authorities (SPAs)</i>

Table 6. List of Target Studies undertaken by the IGFAR TWG in 2024.

The findings from these studies, alongside the insights gathered from the consultations, were used to develop an implementation plan aimed at addressing the identified challenges. These challenges include administrative issues, policy gaps, and the need for legislative reforms to strengthen fiscal decentralization in PNG.

The governors' conference recommended an ideal projection for warrant releases, which was organized as follows:

• 1st Quarter: 40%
• 2nd Quarter: 30%
• 3rd Quarter: 20%
• 4th Quarter: 10%

This arrangement was proposed to help with program implementation according to the budget cycle and to reduce the buildup of rollover funds. The trend of total provincial sector grants and LLG grants released from 2018 to 2023 is shown in the illustrations above.

Table 5. Overall Provincial Sector and LLG Grants released by years.

YEAR	SECTOR	LLG
2018	424,205,233.00	55,008,779.00
2019	448,736,712.00	57,050,646.50
2020	446,683,572.00	60,689,676.00
2021	538,661,377.50	62,370,134.00
2022	553,487,482.00	58,711,902.00
2023	559,219,118.00	70,561,196.00
GRAND TOTAL	2,970,993,494.50	364,392,333.50

It has been projected that function grants will be increased over the years, and rightly so, the return on investment in service delivery should substantiate the amount that is released each year to the provinces and LLGs.

4.4 PROVINCIAL DISTRIBUTION

The following table shows the final amounts (in K’000) for each service delivery function grant for each province for 2025.

Figure 1. 2025 Function and Administration Grants Determination (K ‘000).

Province	Health Function Grant	Education Function Grant	Transport Infrastructure Maintenance Function Grant	Primary Production Function Grant	Village Courts Function Grant	Land Mediation Function Grant	Other Service Delivery Function Grant	Administration Grant	Total Provincial Government Grants
Western	7,017.2	5,990.2	8,728.3	2,372.6	341.6	286.2	945.3	548.3	26,191.1
Gulf	7,043.2	5,973.1	8,594.7	3,312.3	760.5	484.9	1,957.3	2,986.7	31,093.1
Central	8,181.2	9,829.3	16,017.8	4,838.5	980.2	1,078.0	3,259.5	2,695.3	47,699.3
Milne Bay	7,810.1	9,444.7	9,769.9	5,260.9	948.6	811.3	3,431.3	2,753.9	40,776.6
Oro	6,740.3	5,373.1	5,322.0	3,030.6	513.7	189.0	2,139.4	2,456.5	25,522.0
Southern Highlands	7,261.3	9,392.1	9,059.7	3,339.4	874.5	630.2	4,101.5	2,130.4	36,930.4
Hela	7,875.3	7,455.8	7,060.9	2,715.4	855.8	371.1	2,501.1	3,455.4	32,884.7
Enga	7,088.1	11,917.8	13,781.7	6,242.0	1,457.5	412.6	2,167.5	3,204.8	46,285.6
Western Highlands	4,140.2	537.1	1,022.4	396.1	135.4	36.3	245.5	244.5	4,598.1
Jiwaka	6,835.0	9,893.9	14,634.3	1,585.5	471.5	153.2	2,561.8	2,617.8	38,580.2
Simbu	7,974.5	11,768.1	12,032.1	3,033.5	822.8	139.8	3,281.5	4,486.5	44,205.9
Eastern Highlands	7,017.6	10,411.9	17,221.0	2,695.5	633.1	92.2	3,666.2	2,878.8	44,578.0
Morobe	5,024.2	1,071.2	1,326.2	561.1	382.6	127.5	153.0	153.0	7,291.0
Madang	7,698.2	9,371.0	12,918.5	3,743.6	551.8	43.6	3,703.1	3,594.8	42,087.8
East Sepik	8,200.4	17,757.7	29,590.9	5,429.2	901.0	295.8	3,581.4	5,969.9	72,559.9
Sandaun	10,500.2	14,438.1	11,236.5	5,191.1	600.6	155.6	3,062.4	4,354.8	52,068.4
Manus	5,530.3	3,873.2	6,441.0	2,013.3	567.6	104.4	2,022.4	2,614.4	22,031.9
New Ireland	5,542.8	2,433.2	2,798.2	1,034.1	851.6	608.3	730.0	1,216.6	14,089.4
East New Britain	6,652.0	5,692.0	5,377.3	5,830.8	615.8	115.9	1,393.5	797.0	26,166.3
West New Britain	7,258.8	13,395.5	14,573.4	4,114.3	903.8	259.9	3,815.5	3,338.8	47,799.4
TOTAL	141,391	166,019	207,507	66,740	14,170	6,396	48,719	52,498	703,439

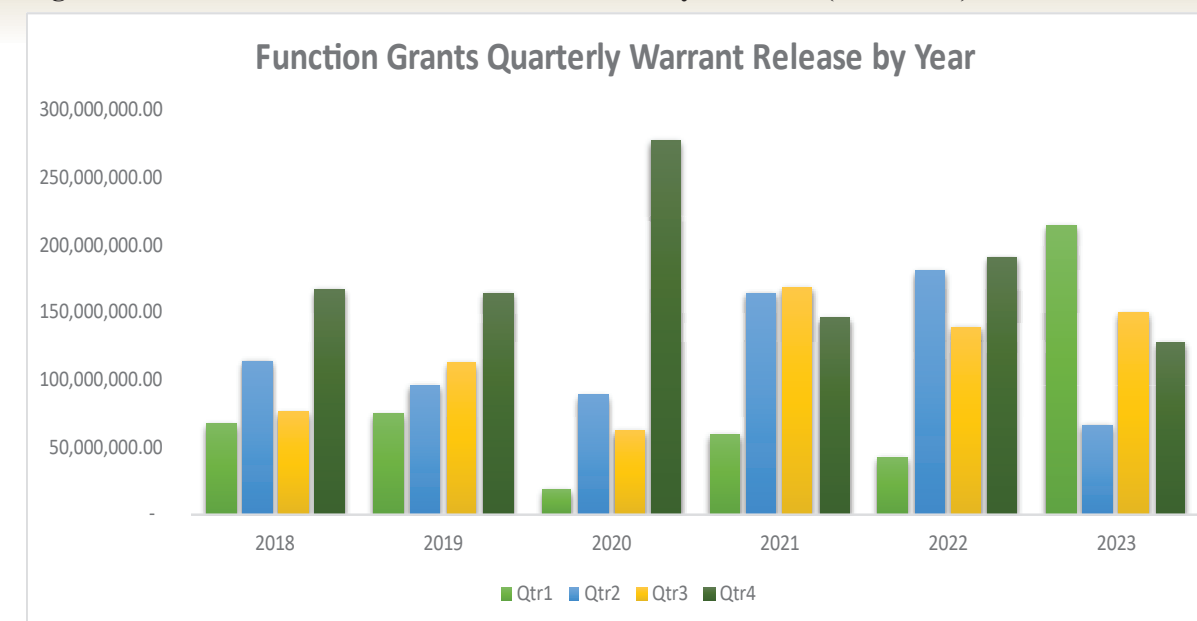
4.5 LLG DISTRIBUTION

The following table shows the conclusive figures (in K’000) representing the LLG grants distributed across provinces for the year 2025. The breakdown distinguishes between Urban and Rural Local Level Governments (LLGs), providing a detailed overview of the funding allocations for each.

Province	Urban LLG Grants	Rural LLG Grants	Total LLG Grants
Western	1,777.2	9,378	11,156
Gulf	692.6	2,689	3,381
Central	0.0	6,111	6,111
Milne Bay	690.5	4,702	5,392
Oro	1,715.3	5,772	7,488
Southern Highlands	2,142.7	4,954	7,096
Hela	2,477.9	4,408	6,886
Enga	569.4	7,130	7,700
Western Highlands	1,911.9	3,774	5,686
Jiwaka	0.0	3,410	3,410
Simbu	905.4	3,801	4,707
Eastern Highlands	1,780.0	5,579	7,358
Morobe	5,329.4	12,151	17,480
Madang	2,036.6	7,260	9,296
East Sepik	1,567.4	9,336	10,904
Sandaun	1,693.6	8,367	10,061
Manus	517.3	1,265	1,783
New Ireland	974.0	2,369	3,343
East New Britain	2,140.2	5,186	7,326
West New Britain	1,335.0	6,178	7,513
TOTAL	30,256.4	113,822	144,078

Figure 2. Local-level Government share by Province for 2025 (K'000)

Figure 8. Function Grant Warrants Release Trend by Quarters (2018-2023)



The trend shown in Figure 8 highlights that a significant portion of funds is typically released in the fourth quarter, reflecting a recurring pattern over the years. However, despite this timing, the overall funding support provided since 2018 has been substantial. A total of K2,970,993,494.50 in provincial sector grants and K364,392,333.50 in Local-Level Government (LLG) grants has been released to support and enhance basic service delivery across provinces. This allocation, as illustrated in Figure 9 and detailed in Table 5, demonstrates the government's commitment to maintaining critical services at the provincial and local levels, even amidst challenges in the timing of fund disbursements.

Figure 9. Total Function Grant Warrant Release by Years

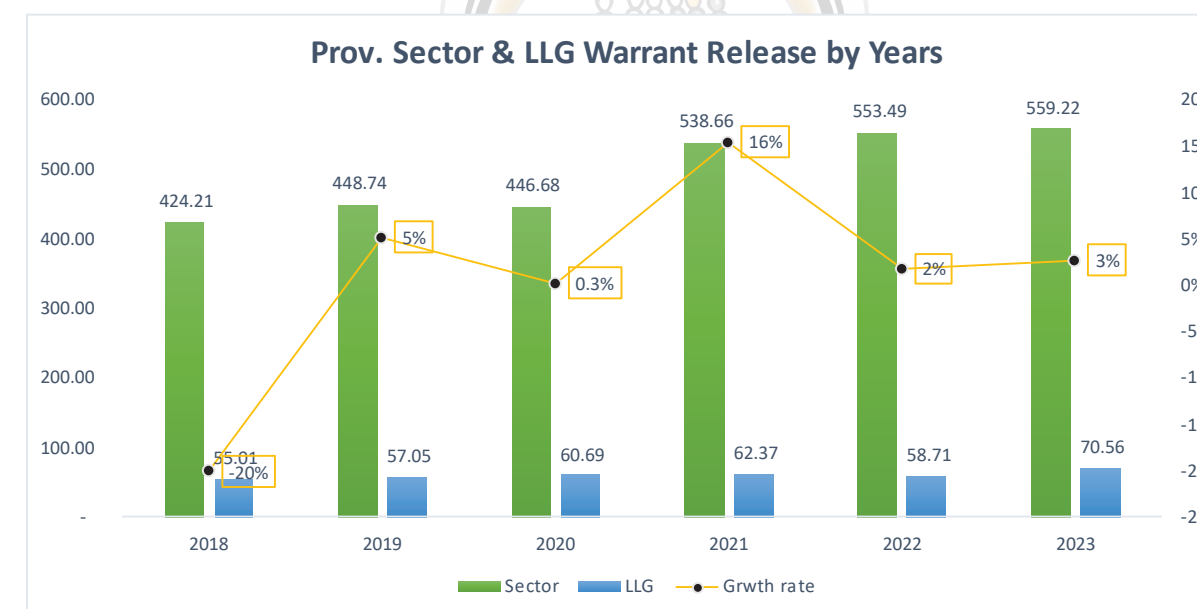


Figure 7. Table on Provincial Government's PGAS – IFMS transition.

Provincial Government transition phase from PGAS to IFMS													
PGAS							IFMS						
2018	2019	2020	2021	2022	2023	2024	2018	2019	2020	2021	2022	2023	2024
Manus	Manus	Manus	Sandaun	Sandaun	Enga	Enga	ENB	ENB	ENB	ENB	ENB	ENB	ENB
NIP	WNB	Sandaun	Western	Western			Central	NIP	NIP	Manus	Manus	Manus	Manus
WNB	Madang	Alotau	Enga	Enga			Oro	ESP	WNB	NIP	NIP	NIP	NIP
ESP	Sandaun	Gulf	Hela				Morobe	ESP	WNB	WNB	WNB	WNB	WNB
Madang	Alotau	Western					Central	Madang	ESP	ESP	ESP	ESP	ESP
Morobe	Gulf	Enga					Oro	Morobe	Madang	Madang	Madang	Madang	Madang
Sandaun	Western	Hela					Central	Morobe	Morobe	Sandaun	Morobe		
Alotau	EHP	SHP					Oro	Alotau	Alotau	Morobe	Sandaun		
Gulf	Enga						EHP	Central	Central	Alotau	Alotau		
Western	Hela						Jiwaka	Gulf	Gulf	Central	Central		
EHP	Jiwaka						Simbu	Oro	Oro	Gulf	Gulf		
Enga	SHP						WHP	EHP	EHP	Oro	Oro		
Hela	Simbu							Jiwaka	Hela	Western	Western		
Jiwaka	WHP							SHP	Jiwaka	EHP	EHP		
SHP								Simbu	SHP	Hela	Hela		
Simbu								WHP	Simbu	Jiwaka	Jiwaka		
WHP									WHP	SHP	SHP		
										Simbu	Simbu		
										WHP	WHP		
17	14	8	4	3	1	1	3	6	12	16	17	19	19

7.3 FUNCTION GRANTS- WARRANTING AND CASH RELEASE

NEFC has been keeping tabs on various ongoing and emerging issues. The effectiveness of planned warrant and cash flow administrative practices has been compromised by discrepancies in warrant and cash releases. These challenges have intensified in both favorable and challenging periods, partly due to inconsistent reforms and conflicting funding priorities.

While RIGFA is generally acknowledged as a successful reform, it's conceivable that the surge in funding over the years wasn't initially foreseen. Nevertheless, the NEFC's recent advocacy has led to the Treasurer committing government funds for function grants. The following graphs show the warrant release information on function grants. The graphs illustrate the timeliness of when funds are warranted from the national level to the sub-national level.

Illustrated in the following are the function grants warrants released by quarter and by years. The trend highlighted here is that much of the funds are released in the fourth quarter which has been an ongoing trend. This presents several issues for program implementation and affects the overall provincial performance in achieving outlined targets and goals.

CHAPTER 5: CALCULATING THE FUNCTION GRANTS

In calculating provincial and LLG grants on a need basis, the NEFC uses a formula that is legislated. This formula has two key steps:

Step 1: Determine the 'fiscal need' of each Province and LLG by comparing their estimated costs and assessed revenues.

Step 2: Using the different levels of financial need, calculate the share of the equalization pool going to each Province and LLG.

5.1 SUMMARY OF LEGISLATIVE PROVISIONS

Two key pieces of legislation provide the basis for the NEFC to determine how much each provincial and LLG receive as grants.

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 supported by a more detailed description of the *Intergovernmental Relations (Functions and Funding) Act 2009*.

2. Intergovernmental Relations (Functions and Funding) Act 2009

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

Part 3 explains the equalization system of the new intergovernmental financing arrangements, which also clearly highlights the fiscal need basis upon which provincial and LLG grants will be calculated.

5.2 THE FRAMEWORK FOR DETERMINING FISCAL NEEDS OF PROVINCIAL AND LOCAL-LEVEL GOVERNMENTS

Throughout the reform process, a significant effort was made to enhance the understanding of the financial requirements of Provinces and LLGs. The fundamental concept underlying fiscal needs revolves around discerning the disparity between the expenses associated with delivering designated services and fulfilling responsibilities, and the revenue accessible to provincial and LLGs to cover these obligations.

In instances where a province or LLG boasts a robust revenue foundation, it signifies a favorable fiscal capacity. Essentially, this indicates a robust alignment of assessed revenues vis-à-vis costs. The NEFC, in its evaluation, categorizes this scenario as having a fiscal need amounting to zero. In simpler terms, it possesses the fiscal capability to meet service delivery functions without necessitating additional funds from the national government.

The quantification of the required funds for a province and LLG is termed the fiscal needs amount. This figure is derived from a meticulous calculation that takes into account the recurring costs associated with delivering the designated service functions and responsibilities, coupled with the existing revenue at the disposal of Provinces and LLGs to meet these service requirements.

4.2.1 FISCAL NEEDS AMOUNTS FOR PROVINCIAL GOVERNMENTS

The fiscal needs amount for a provincial government is calculated using the formula:

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

-where.

“Estimated recurrent cost of assigned service delivery functions and responsibilities” is the estimated recurrent cost for the provincial government in performing its assigned service delivery functions and responsibilities for the fiscal year, including the necessary and incidental costs of administration for 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.

5.2.2 FISCAL NEEDS AMOUNTS FOR LOCAL-LEVEL GOVERNMENTS

The fiscal needs amount of each LLG for each fiscal year is calculated using the formula –

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

Where:

“Estimated recurrent cost of assigned service delivery functions and responsibilities” is the recurrent cost to the LLG for performing its assigned service delivery functions and responsibilities for the fiscal year, including the necessary and incidental costs of administration of the LLG.

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

Since the inception of the new system, the NEFC has predominantly been assessing LLG fiscal needs against the costs carried out at the district level in proportion to the district population. This has been a proxy for the assessment of fiscal needs at the LLG level mainly because of the unavailability of revenue data. Coherently, the NEFC assesses LLG revenues annually as equal to zero.

Urban and Rural Local-Level Governments have different assigned service delivery functions and responsibilities. Though they have different revenues available to them, the question lies with how best the NEFC can gather these revenue data and assess them using the legislated formula. Eventually, the NEFC expects to obtain better information on the revenues of urban and Rural Local-level Governments and would then assess these more accurately.

5.3 ESTIMATING THE COST-OF-SERVICE DELIVERY

Cost is one of the two key determinants that impact provinces’ share of the function and administration grants. Each province has differing cost factors due to its unique circumstances.

In the pursuit of a more equitable distribution of resources through intergovernmental financial reforms, a crucial step involved defining the distinct roles and responsibilities of both Provinces and LLGs. This clarity was essential for accurately assessing the costs associated with the services they were entrusted to deliver.

CHAPTER 7: FINANCIAL PERFORMANCE AND COMPLIANCE

7.1 PROVINCIAL EXPENDITURE REVIEW

The Provincial Expenditure Review (PER) has been an important activity and a core function of the National Economic and Fiscal Commission (NEFC) since its inception in 2006. The Provincial Expenditure Review (PER) undertakes a comprehensive analysis of provincial government spending, particularly focusing on Function Grants allocated to key areas outlined in the Medium-Term Development Plan (MTDP) or Medium-Term Provincial Plan (MPA). Its primary emphasis remains on assessing how provincial administrations utilize their recurrent budget to provide essential Public Goods and Services.

While historically centered on provincial administration expenditure, the NEFC has broadened the scope to include frontline service delivery units such as rural health centers, schools, and district administrations. These entities are pivotal in facilitating service provision, encompassing functions like managing village courts, land mediation services, and the upkeep of vital infrastructure such as roads, wharves, jetties, and bridges.

The NEFC through the PER exercise had developed an efficient monitoring mechanism for provincial governments' use of recurrent grants. The PFM process practiced through the review is subject to changes in government policies. A change in the government accounting systems can inevitably affect the process by which the NEFC undertakes its review.

The PNG government in 2017 sanctioned the implementation of the Integrated Financial Management System (IFMS) to replace the legacy PNG Government Accounting System (PGAS). This directive has prompted provincial governments to transition from the legacy PGAS to IFMS. Whilst the adaptation of this new accounting system is aimed at promoting transparency and accountability, it also presents new challenges to the scene in terms of:

1.	<i>A prolonged transition phase for provinces from PGAS to IFMS from 2018 – 2023</i>
2.	<i>A prolonged transition phase for districts</i>
3.	<i>A prolonged transition phase for provincial health authorities</i>
4.	<i>Data migration and harmonizing provincial government program budgeting and expenditure chart of accounts.</i>
5.	<i>Non-uniformity of program budget and expenditure chart of accounts string codes.</i>

This has not only affected NEFC’s PER process but also provincial governments in terms of budgeting, expenditure, and reporting according to PFM processes and guidelines. The mammoth task of sorting PER reports for fiscal years succeeding 2017 is currently being undertaken by the Commission.

7.2 PGAS TO IFMS TRANSITION PHASE

The transition phase is one of the main challenges. The timing of the transition varies between provinces, with some making the switch in the middle of the year. This can cause disruptions in operations and data recording, leading to incomplete or partial data in PGAS and IFMS. As a result, there is a risk of data loss or incorrect records, which can affect the assessment and reporting process.

As shown in Figure 5 below, the transition started in 2018, with three provinces moving from PGAS to IFMS. Other provinces followed suit from 2019 to 2023. However, one province, Enga, has chosen to remain on PGAS.

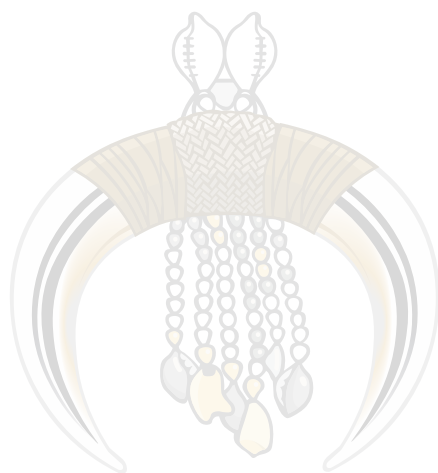
The Land Mediation Function Grant as it was created in 2016 is yet to establish its minimum priority activities and its performance indicators through another consultation process with key stakeholders such as the Department of Treasury, Department of Finance, Department of Justice & Attorney General, and Provincial Administrations.

6.4 IMPROVING COMPLIANCE WITH CONDITIONS FOR FUNDING

Conditions for function grants (including the Minimum Priority Activities) and management of expenditure are provided for in the Function Grant and Administration Grant Determination and the 'Budget and Expenditure Instructions' issued by the Secretary for Treasury in August 2012. The Budget and Expenditure Instructions specify:

- which 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 stakeholders.

The Department of Treasury, in conjunction with the Department of Provincial and Local Government Affairs and the NEFC, continues to work with provinces to improve compliance with these Budget and Expenditure Instructions. The NEFC has undertaken a series of budget workshops with all provinces to further improve budget compliance with the use chart of accounts coding and other budget scorecard criteria.



The year 2009 marked a significant milestone with the enactment of the Inter-governmental Relations (Functions and Funding) Act 2009 and the subsequent official declaration of the Function Assignment Determination in June 2009. These legislative measures delineated the specific functions and responsibilities of Provinces and LLGs. The primary objective was to dispel confusion, providing a clear framework that facilitated effective planning, budgeting, delivery, and monitoring of their accountable activities. For a more in-depth exploration of these assignments, The Handbook to The Determination of Service Delivery Functions and Responsibilities by The Department of Provincial & Local Level Government Affairs offers comprehensive insights.

Crucially, the cost estimates provided by the NEFC are rooted in the actual expenses required to execute these functions, irrespective of whether they are carried out by the Province or LLG. This approach is deliberate, aiming to empower both entities with the fiscal capacity needed to fulfill their myriad responsibilities.

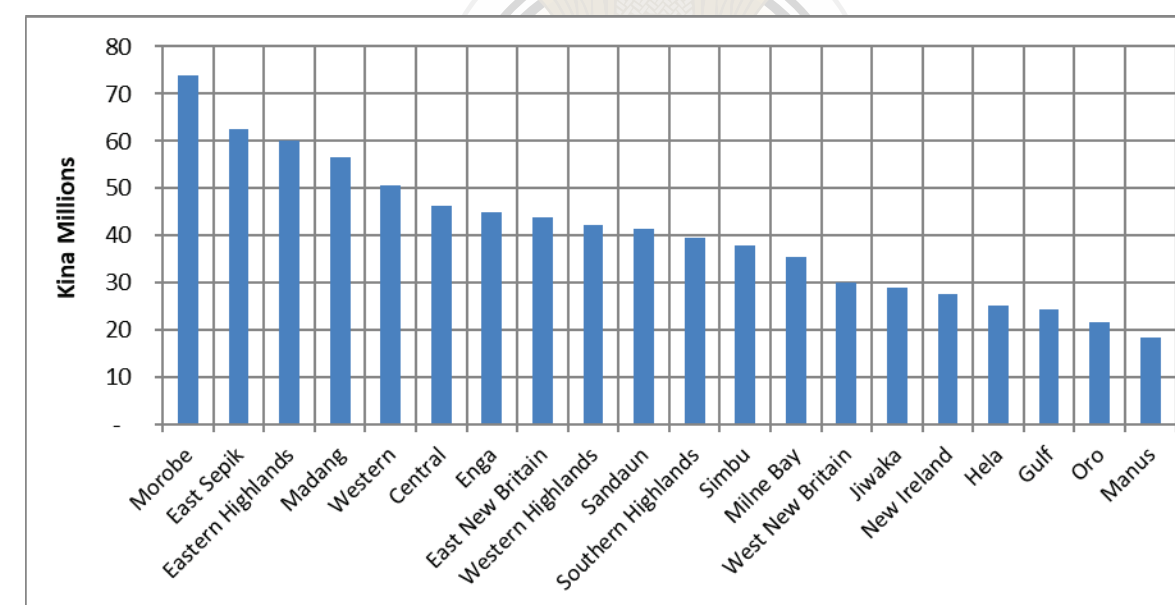
5.4 COST OF SERVICE ESTIMATE

Every five years, the NEFC engages in a comprehensive costing analysis of provincial government functions, serving as the foundation for identifying fiscal needs. The most recent update to this cost estimate occurred in 2020, with annual indexing implemented thereafter to account for inflation and population growth-related cost changes.

For each determination year, the calculation relies on costs from the second fiscal year preceding it. In the case of the 2025 determination, the 2023 cost estimate is utilized, ensuring a consistent alignment between revenues and costs.

The graph below outlines the estimated costs for each province in 2023.

Figure 3. 2023 Cost of Service Estimate by Province



5.5 ASSESSED REVENUES

The process of determining provincial financial needs involves a crucial step—the calculation of available own-source revenues, constituting the second part of the formula. This quantification hinges on the disparity between provincial revenues and the costs associated with assigned service delivery functions and responsibilities. To adhere to the formula, the NEFC is tasked with collecting and evaluating revenue data for provinces. Traditionally, these involved provinces extracting data from their PGAS, but the advent of the Integrated Financial Management System (IFMS) saw a transition for several provinces. However, no system is flawless, and with IFMS in play, there were certain drawbacks. In 2023, the collection of revenue data faced delays, primarily attributed to capacity issues.

Despite these challenges, the NEFC acknowledges the significance of this revenue source in their assessments. Assessed revenues represent the anticipated total amounts that the provincial government is likely to receive in the fiscal year for executing its designated service delivery functions.

Assessment of revenues for a fiscal year typically looks back to the second preceding year for the last available year of complete and actual data. In the case of the 2025 distribution year, the NEFC based its assessments on the revenues from 2023. The sources of revenue are outlined below:

5.6 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, as reported in the National Budget Papers.

5.6.1 GOODS AND SERVICES TAX

Provincial governments receive Goods and Services Tax (GST) distributions paid through the IRC. 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 section 40 of the *Intergovernmental Relations (Functions and Funding) Act 2009*. 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). The amount of GST distributed under the Act is 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 concerning the second preceding year to that fiscal year as this will be the last available year of data. So, GST distribution for 2025 will be based on 60% of net inland GST collected from the second preceding year (i.e., 2022).

5.6.2 BOOKMAKERS TAX

Bookmakers Tax is also administered by the IRC. Bookmakers' Tax received by provincial governments is 40% of the revenues collected in the province in the second preceding year.

5.6.3 OWN-SOURCE REVENUE

These are local taxes, charges, and receipts collected by the provincial administrations, which is the primary revenue base for the provinces. These comprise:

- licenses for liquor outlets.
- licenses for gambling establishments.
- motor vehicle registration and license fees.
- proceeds from business activities, rents, and sale of assets.
- provincial road users' tax.
- court fees & fines; and
- Other fees & charges.

Table 4. Minimum Priority Areas and the Performance Indicators.

Minimum Priority Activity	Performance Indicator
<u>Health</u> 1. Operation of rural health facilities 2. Drug distribution* 3. Integrated health outreach patrols	i. Total number and names of health facilities ii. Number of Health Facilities open and staffed iii. Health facilities with access to running water in the labor ward i. Several months health facilities stocked with essential supplies in the last quarter i. A total number of health patrols conducted and then, a. Number of administrative supervision patrols to health facilities b. A number of patrols with specialist medical officers to health facilities c. A number of maternity child health patrols to health facilities.
<u>Education</u> 4. Provision of school materials 5. Supervision by provincial/district officers 6. Operation of district education offices	i. Total number of schools by type ii. Percentage of schools that received basic school supplies before 30th April. i. Number of schools visited by district / provincial education officers i. A number of District Education Offices provided quarterly performance reports.
<u>Transport Maintenance</u> 7. Road and bridge maintenance 8. Airstrip maintenance 9. Wharves and jetties maintenance	i. Names and approximate lengths of provincial roads maintained ii. Names of bridges maintained i. Names of rural airstrips maintained i. Names of wharves, jetties, and landing ramps maintained
<u>Agriculture</u> 10. Extension activities for agriculture, fisheries, and forestry	i. Number of extension patrols conducted by provincial government staff and ii. Number of people who attended extension sessions
<u>Village Courts</u> 11. Operations of Village Courts	i. Number of village courts in active operation ii. Number of village courts supplied with operational materials iii. Number of inspections of village courts

*It is understood that the distribution of drug supplies is being managed through donor support. Whilst this activity was identified as a minimum priority activity, proper assessment and monitoring of this activity are being considered by the NEFC. In the meantime, this should not deter the province from reallocating the cost previously budgeted for the drug distribution to other areas of priority expenditure.

*It is also understood that the establishment of the TTF has induced provinces to use the Education Function Grants for other activities. The NEFC still maintains its objectivity by encouraging provinces to fund the distribution of school supplies as TTF is only a policy and NEC decision and can be changed at times.

6.3 MINIMUM PRIORITY ACTIVITIES AND PERFORMANCE INDICATORS

In 2009, the Secretary of Treasury issued Budget and Expenditure Instructions calling for Provinces to adequately fund eleven (11) specific service delivery activities. These eleven activities were identified as a

basic provincial responsibility across the nominated five key function grant categories of Agriculture, Education, Health, Transport Infrastructure, and Village Courts (all MTDS priority areas) and are known as the Minimum Priority Activities (MPAs).

These MPAs were arrived at after extensive consultation with national agencies, Provinces, and PLLSMA. MPAs should assist provincial governments in prioritizing effective and targeted service delivery outcomes at the district and LLG levels.

Provincial governments must create identifiable activity codes for each MPA in their respective budgets and request performance reporting from sector managers. The MPAs are:

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 outreach patrols
- Drug distribution

Transport Infrastructure Maintenance

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

Village Courts

- Operation of village courts
- Supply of uniforms/inspection of village courts

Additionally, there is a set of very specific indicators against which each of these MPAs could be measured.

The full set of MPAs and performance indicators are provided on the following pages.

Minimum Priority Activities and Performance Indicators

The Minimum Priority Activities **must** be funded from service delivery grants within each financial year. These form part of the conditions of the service delivery grants.

These minimum activities are **minimum priority activities that the NEFC monitors and encourages provincial administrations to adequately fund from their total function grant allocations**. Function grants can still be used for funding other recurrent goods and services activities within that functional area.

The NEFC estimates that in 2023 (the second preceding year), provinces raised **K793.9 million**. From this revenue source. This data is obtained from both the PNG Government Accounting System (PGAS) internal revenue electronic summary files held by the Department of Finance and the Integrated Financial Management System (IFMS). It is well understood that provinces are now transitioning into the Integrated Financial Management System (IFMS). However, it's acknowledged that not all revenues received by provincial governments are meticulously documented in PGAS and IFMS

5.6.4 MINING AND PETROLEUM ROYALTIES

When it comes to provinces hosting mining and petroleum activities, royalties become a potential boon. These royalties are determined through a Memorandum of Agreement (MOA) involving the provincial government, customary landowners, the mining company, and other stakeholders. For petroleum projects negotiated post-1988, the provincial government's share is outlined in the pertinent mining and petroleum legislation.

Since the late 1980s, the national government has refrained from claiming mining and petroleum royalties in MOAs for new projects. Instead, these royalties are distributed among landowners, local governments, and provincial governments in diverse ways, contingent on the specific project. Additionally, provincial governments sometimes commit to long-term agreements, allocating a portion of their royalties to local governments or non-government entities for particular projects.

As of 2023, the NEFC estimates that provinces collectively received millions of kinas from royalty and dividend payments, sourced directly from mining and petroleum companies and verified by government agencies such as the Mineral Resources Authority (MRA) for mining projects and the Department of Petroleum and Energy (DPE) for petroleum projects.

Figure 4. Actual revenues collected by the province in 2023

Province	GST Distributions	Bookmakers Tax	Own Source Revenues & Others	Royalties	Dividends
Western	24,000,000	18,572	1,969,605	37,300,000	0
Gulf	3,000,000	0	452,079	0	0
Central	5,000,000	0	11,323,348	0	0
Milne Bay	11,000,000	0	2,437,220	0	0
Oro	7,000,000	35,964	1,783,756	0	0
Southern Highlands	16,000,000	0	15,543,019	0	0
Hela	6,000,000	0	0	0	0
Enga	9,000,000	0	22,090,524	0	0
Western Highlands	83,000,000	382,153	7,996,044	0	0
Jiwaka	11,000,000	0	0	0	0
Simbu	14,000,000	142,202	1,171,932	0	0
Eastern Highlands	45,000,000	561,438	7,974,949	2,064,978	0
Morobe	217,000,000	1,927,920	11,349,660	5,301,233	0
Madang	39,000,000	3,030,730	2,044,173	2,311,964	0
East Sepik	23,000,000	284,187	3,344,399	0	0
Sandaun	7,000,000	0	1,377,250	0	0
Manus	4,000,000	0	615,239	0	0
New Ireland	26,000,000	0	2,403,841	9,447,652	0
East New Britain	44,000,000	222,107	7,531,459	0	0
West New Britain	22,000,000	509,914	12,944,779	0	0
TOTAL	616,000,000	7,115,187	114,353,275	56,425,827	0

5.6.5 ASSESSING REVENUES

To calculate the different funding levels of the different function grants, 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 Projects

- 80% of *royalties and 50% of dividends from mining and petroleum projects*. This gives the recognition that some revenues are spent on the development of mining infrastructure.

ii) Own-source Revenues

- The NEFC takes into account only 50% of its *own source revenues* collected to encourage provinces to continue to collect and enhance their revenue base¹.

iii) Goods and Services Tax (GST)

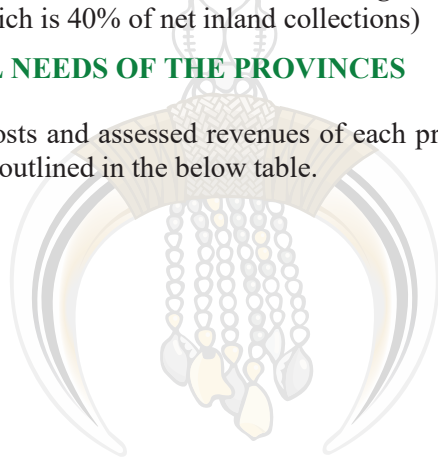
- 100% of *GST* is distributed under the *Intergovernmental Relations (Functions and Funding) Act 2009* (which is 60% of net inland collections).

iv) Bookmakers' Turnover Tax

- 100% of *Bookmakers Tax* is distributed under the *Intergovernmental Relations (Functions and Funding) Act 2009*. (Which is 40% of net inland collections)

5.7 CALCULATING FISCAL NEEDS OF THE PROVINCES

Bringing together the estimated costs and assessed revenues of each province gives a calculation of fiscal needs. The calculation for 2025 is outlined in the below table.



¹Own Source Revenues refer to the income that provincial governments generate on their own, without relying on funding from the national government. This includes money collected from taxes, fees, licenses, fines, and charges for services provided within their jurisdiction.

CHAPTER 6: CONDITIONS ATTACHED TO THE USE OF THE FUNCTION AND ADMINISTRATION GRANTS

In 2020, the NEFC issued a letter to the Secretary for Treasury to remind provinces of the “Conditions of Funding”, purposely on the use of function grants and roll-overs. The subsequent approach would involve the Secretary issuing a directive to provinces highlighting the conditions outlined in the Budget Expenditure Instructions (BEI). This was a necessary approach as assessments on the Service Delivery Function Grants showed misapplication on the use of these grants.

6.1 SERVICE DELIVERY FUNCTION GRANTS

Service Delivery Function Grants are provided to provincial administrations to ensure that a minimum set of core services are adequately funded to benefit the majority of people across Papua New Guinea.

Section 65 of the *Intergovernmental Relations (Functions and Funding) Act 2009* serves as the basis on which the Secretary for the Department of Treasury may, in consultation with the NEFC, determine the conditions over the administration of the following grants; as follows:

- service delivery function grants.
- administration grants.
- rural LLG grants.
- urban LLG grants.
- staffing grants, and allowances for village court officials.
- Other development needs.

The conditions are subject to the provisions outlined under section 66 of the Act.

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 Expenditure Instructions.

The following service delivery function grants will be in operation in 2025:

- Education Service Delivery Function Grant.
- Health Service Delivery Function Grant.
- Transport Infrastructure Maintenance Grant.
- Village Courts Function Grant (Operations).
- Land Mediation Function Grant (*newly established*)
- Village Courts Allowances Grant.
- Agriculture Service Delivery Function Grant.
- Other service delivery Function Grant (*Grant composed of funding for other service sectors such as Community Development, Lands, Commerce, Environment, etc.*).

6.2 ADMINISTRATION GRANTS

This grant is to fund general overhead costs or meet the day-to-day operational costs of the provincial administration.

The Administration Grant **cannot** be used to pay salaries or other personal emoluments, casual wages, or debt payments. This grant is intended to fund the operation of the administration sectors such as the Legal Services; Human Resource Development; Policy, Planning and Research; Internal Audit; Assembly/Parliamentary Services; Office of the Administrator; and LLG Administration.

Forecasting, by its nature, introduces an element of uncertainty, leading to potential disparities between the calculated estimates and the actual revenues recorded later in the year. Moreover, there are occasions when data from other government agencies, initially utilized in NEFC's calculations, undergoes subsequent revisions.

Despite these challenges, the NEFC adheres to a consistent practice of maintaining its recommendations unchanged in response to revised data or discrepancies in actual revenues. The NEFC conducts its calculations diligently, employing its best efforts and utilizing the available data at the time. This approach ensures the timely determination of funding ceilings for Provinces, even if adjustments may be required based on later-confirmed figures.

5.11 RESOURCE-RICH PROVINCES & THE FUNDING ARRANGEMENTS.

Ever since the initiation of RIGFA, there have been remarkable changes in funding approaches. However, the NEFC has remained steadfast in emphasizing the importance of service delivery. The utilization of provinces' own-source revenues has consistently been a primary concern. Drawing insights from the past "Kina per Head" System, the reform now plays a crucial role in distributing funds to provinces in an "equitable" manner, emphasizing a needs-based approach to funding arrangements. The NEFC carefully considers provincial fiscal capacities when allocating funds and assessing revenues against fiscal needs. A fiscal need of zero signifies that a province possesses the capacity to sustain service delivery without additional support from the national government.

This aligns with the principles of intergovernmental financing arrangements, where provinces with higher fiscal capacities are expected to use their internally generated resources to complement government funding for basic service delivery.

The Inter-governmental Relations (Functions and Funding) Act of 2009 introduced a five-year transitional arrangement, ensuring that provinces would not receive less funding than they did in 2008. This safeguarded resource-rich provinces like Morobe, New Ireland, and Western, allowing them to continue receiving grants. However, this arrangement concluded in 2016, and the transitional guarantee funding ceased in the 2017 Budget. Consequently, after the 2017 and 2018 Budgets, Morobe and New Ireland provinces became ineligible for function and administration grants.

Despite this, New Ireland has re-entered the system, facing a low assessed fiscal capacity due to an arrangement diverting royalties directly to districts. This has disadvantaged the province's ability to effectively plan and budget for service delivery obligations.

Morobe Province finds itself among the recipients of function grants in the 2024 and 2025 budget, thanks to the continuous reform efforts laid out in the Intergovernmental Financing Arrangement Review (IGFAR).

Figure 5. Fiscal Needs of Provinces for 2025 (Kina '000)

Provinces	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
Western	72,509.1	50,039.7	22,469.5	3.1%
Gulf	35,713.0	2,626.0	33,087.0	4.6%
Central	68,778.0	18,020.0	50,758.0	7.0%
Milne Bay	53,410.0	10,018.6	43,391.4	6.0%
Oro	33,679.2	6,520.6	27,158.6	3.8%
Southern Highlands	59,870.1	20,571.5	39,298.5	5.4%
Hela	39,793.4	4,800.0	34,993.4	4.8%
Enga	67,498.9	18,245.3	49,253.6	6.8%
Western Highlands	65,687.4	70,703.7	0.0	0.0%
Jiwaka	49,854.2	8,800.0	41,054.2	5.7%
Simbu	58,940.4	11,899.7	47,040.6	6.5%
Eastern Highlands	89,525.2	42,088.6	47,436.6	6.6%
Morobe	104,156.6	185,058.2	0.0	0.0%
Madang	81,282.9	36,496.2	44,786.7	6.2%
East Sepik	97,512.4	20,299.5	77,212.8	10.7%
Sandaun	61,695.9	6,288.6	55,407.3	7.7%
Manus	26,152.3	2,707.6	23,444.7	3.2%
New Ireland	41,464.3	29,560.0	11,904.2	1.6%
East New Britain	62,343.7	39,143.4	23,200.3	3.2%
West New Britain	75,344.9	24,480.3	50,864.5	7.0%
TOTAL	1,245,211.8	608,367.8	722,761.9	100.0%

5.8 CALCULATING INDIVIDUAL PROVINCE SHARES

Once fiscal needs have been calculated, the next step is to apportion the shares of the equalization pool to determine the final amounts going to each provincial government. The calculation of fiscal needs recognizes that each province is different, and as such, each province will receive a different share of the equalization amount. Once the individual province share is calculated the next step is to divide up the total share into service delivery function grants and an administration grant.

For 2025, the individual province share is calculated using the formula:

$$\text{equalization amount for provinces} \times \frac{\text{fiscal needs amount of individual province}}{\text{total fiscal needs amount of provinces}} = \text{individual province share}$$

Where –

‘Equalization amount for provinces means the amount equal to the province share specified in the determination made under Section 17 (1) (a) 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 fiscal needs amounts of the provincial governments that have fiscal needs amounts greater than zero for the relevant fiscal year.

Figure 6. 2025 Individual Province Share (K'000)

Province	Transitional Individual Province Guarantee (a)	Estimated Fiscal Needs (Estimated costs minus assessed revenues)	Percentage of total fiscal needs	Funding based on percentage of total fiscal needs (b)	Individual Province Share (a) + (b)
Western	5,075.6	22,469.5	3.1%	21,115.5	26,191.1
Gulf	0.0	33,087.0	4.6%	31,093.1	31,093.1
Central	0.0	50,758.0	7.0%	47,699.3	47,699.3
Milne Bay	0.0	43,391.4	6.0%	40,776.6	40,776.6
Oro	0.0	27,158.6	3.8%	25,522.0	25,522.0
Southern Highlands	0.0	39,298.5	5.4%	36,930.4	36,930.4
Hela	0.0	34,993.4	4.8%	32,884.7	32,884.7
Enga	0.0	49,253.6	6.8%	46,285.6	46,285.6
Western Highlands	4,598.1	0.0	0.0%	0.0	4,598.1
Jiwaka	0.0	41,054.2	5.7%	38,580.2	38,580.2
Simbu	0.0	47,040.6	6.5%	44,205.9	44,205.9
Eastern Highlands	0.0	47,436.6	6.6%	44,578.0	44,578.0
Morobe	7,291.0	0.0	0.0%	0.0	7,291.0
Madang	0.0	44,786.7	6.2%	42,087.8	42,087.8
East Sepik	0.0	77,212.8	10.7%	72,559.9	72,559.9
Sandaun	0.0	55,407.3	7.7%	52,068.4	52,068.4
Manus	0.0	23,444.7	3.2%	22,031.9	22,031.9
New Ireland	2,902.5	11,904.2	1.6%	11,186.9	14,089.4
East New Britain	4,364.1	23,200.3	3.2%	21,802.2	26,166.3
West New Britain	0.0	50,864.5	7.0%	47,799.4	47,799.4
Total	24,231.3	722,761.9	100.0%	679,207.7	703,439.0

5.9 INDIVIDUAL LOCAL-LEVEL GOVERNMENT SHARE

The individual rural local-level share is the amount an individual rural LLG receives from the equalization system.

The LLG share is divided into two amounts: one for urban LLGs, and another for rural LLGs. These are called individual local-level shares.

The amounts for individual urban or rural LLG for the relevant fiscal year are calculated using the formula below:

$$\text{equalization amount for urban Local-level governments} \times \frac{\text{fiscal needs amount of individual urban Local-level Government}}{\text{total fiscal needs amount of urban Local-level Governments}} = \text{individual Local-level share}$$

Where –

‘Equalization amount for urban LLGs’ means the amount estimated by the NEFC to be the urban LLGs’ share of the local-level share specified in the determination made under Section 17 (1) (b) that is in force on 30 April of the immediate preceding fiscal year;

‘Fiscal needs amount of individual urban LLG’ means the fiscal needs amount of that urban LLG for the relevant fiscal year;

‘Total fiscal needs amount of urban LLGs’ means the total fiscal needs amounts of the urban LLGs that have fiscal needs amounts greater than zero for the relevant fiscal year.

A similar formula is used to calculate the rural LLG share.

In the realm of rural LLGs, their revenue streams are generally meager, yet their cost landscapes vary significantly. Factors contributing to this divergence include heightened expenses attributed to geographical remoteness or the diverse demographics they serve. Despite the commonality of limited or nonexistent revenues among rural LLGs, their fiscal needs differ due to the inherent variations in their cost structures.

Divergence extends beyond revenue disparities to the assigned service delivery functions and responsibilities, outlined by the Function Assignment Determination endorsed by the NEC. Urban and rural LLGs not only grapple with distinct duties but also contend with disparate revenue capacities. Urban counterparts boast the ability to generate substantially higher revenues, enabling them to cover a more substantial portion of their service delivery costs. Conversely, rural LLGs navigate a landscape characterized by modest revenues and a more limited scope of service delivery functions and responsibilities.

The assessment of revenues for both rural and urban LLGs often hovers around the zero mark. This stems from the incomplete and subpar quality of available revenue data. **Section 4.2.2** underscores this challenge, indicating that the NEFC, in the absence of comprehensive revenue data, resorts to employing District costs and population as surrogates for determining LLG costs. This approach, while providing a foundational assessment for both Rural and Urban LLGs, is a provisional measure. The NEFC anticipates refining its evaluation with more accurate information on urban LLG revenues in the future. However, the prospect of accurately assessing revenues for the vast expanse of over 300 rural LLGs remains uncertain, keeping rural LLG revenues at an estimated zero for the foreseeable future.

The total LLG share is divided between rural and urban LLGs in the same proportion as provided in the 2009 budget, i.e., 79% rural, and 21% urban.

The rural LLG share is then further divided into 300 plus individual LLG amounts, based on district costs and population in each LLG. Considerably, the NEFC understands the nature of the establishment of rural LLGs. Should new LLGs be gazette in the foreseeable future, LLG shares will have to be shared accordingly.

For urban LLGs, their funding is determined as their share of funding based on their assessed fiscal needs².

5.10 A NOTE ON CALCULATING THE DETERMINATION

At times, the NEFC faces a challenge when current revenue data isn't readily accessible during its initial calculations in the early stages of the financial year, typically around May. In such instances, the NEFC resorts to forecasting revenues based on historical data, often relying on a 3-year average.

² Fiscal needs in the context of assessing District costs in proportion with District population.