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PERFORMANCE AUDIT REPORT

PAPUA NEW GUINEA

**Structural Adjustment Loan
(Loan 3218-PNG)**

**Economic Recovery Program Loan
(Loan 3934-PNG)**

June 7, 2000

Operations Evaluation Department

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Currency Equivalents

Currency Unit: Kina (K)

1992	1.0367
1993	1.0221
1994	0.9950
1995	0.7835
1996	0.7588
1997	0.6975
1998	0.4859
1999	0.3620

Abbreviations and Acronyms

EEC	European Economic Community
ERP	Economic Recovery Program
GDP	Gross Domestic Product
GOPNG	Government of Papua New Guinea
ICR	Implementation Completion Report
ID	Institutional development
IMF	International Monetary Fund
NGOs	Non-governmental organizations
OED	Operations Evaluation Department
PNG	Papua New Guinea
SAL	Structural Adjustment Loan

Fiscal Year

January 1 – December 31

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June 7, 2000

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

**SUBJECT: Papua New Guinea – Structural Adjustment Loan (Ln. 3218-PNG) and
Economic Recovery Program Loan (Ln. 3934-PNG)**

Attached is the Performance Audit Report (PAR) on the Structural Adjustment Loan (SAL) (Ln. 3218 for US\$50 million, approved in FY90) and the Economic Recovery Program (ERP) (Ln. 3934 for US\$50 million, approved in FY95). Both loans were fully disbursed.

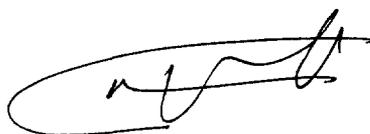
Both the SAL and ERP aimed to help the government restore macroeconomic stability and stimulate non-mining production in order to set the economy on a more sustainable and equitable growth path. The objectives and interventions of both Bank operations were appropriate. The rationale for structural adjustment in PNG continues to be valid: until the non-mining sector expands most people will be left out of the development process and the economy will be subject to commodity price shocks and the eventual depletion of its mineral resources.

While each operation got off to a good start, in both cases, the momentum for reform began to abate once initial stabilization objectives had been met. Under the SAL, good early progress was made on stabilizing the economy and commencing tax, trade, and fiscal reforms. However, after mid-1992, a new government halted the SAL program and began pursuing expansionary fiscal and monetary policies. By 1994, the trade and tax measures that had been taken were effectively reversed; there had been no shift in the composition of expenditures; newly introduced expenditure control mechanisms were ineffective; little progress had been made on privatization and civil service reforms, and a new macroeconomic crisis was emerging. Better progress seen under the ERP, although only the early stages of most reforms were seen. Macroeconomic stability was restored by the end of 1995 and progress was made in addressing some price and trade distortions; in increasing budget allocations to the social sectors; and in improving government oversight in the forestry sector. However, progress was slow and difficult as GOPNG's commitment to reform ebbed and only after the Bank threatened to cancel the second tranche of the loan were most of the loan conditions met. After mid-1997, external shocks arising from a drought and the East Asian crisis, as well as ineffective fiscal management further disrupted progress and brought about a crisis that persists to date.

The PAR agrees with the ICR's *unsatisfactory* outcome rating for the SAL as the operation failed to have a significant lasting impact on the country. Institutional development impact is rated *negligible*, sustainability *unlikely*, and Bank performance *unsatisfactory*. The outcome of the ERP is rated *marginally satisfactory* rather than satisfactory as per the ICR, institutional development impact is rated *modest*, sustainability *uncertain*, and Bank performance *satisfactory*. While the operation realized its immediate objective of bringing about the early stages of several reforms, unfortunately, little was done to consolidate and advance these measures after the initial impetus of the loan ended. With few follow-on actions, a series of external shocks, and inadequate fiscal management after 1997, the long-term benefits of the

program have been limited: there have been no signs of a shift in production structure and social indicators have been at best unchanged over the past decade. The present government is designing a further reform program to build on and help sustain some of the achievements under the ERP.

Lessons from the two adjustment operations suggest that future adjustment lending to PNG should be: (i) based on clear indications of broad-based support and ownership of the reform agenda to ensure implementation during both hard and good times; (ii) part of a wider reform effort on the part of GOPNG aimed at redressing a range of socio-political development constraints, including governance, civil service reform, law and order, political reform, land reform, and consensus-building at the village/clan level; (iii) aimed at guiding GOPNG through a gradual but consistent implementation of reforms over an extended period; (iv) complemented by a parallel effort to consolidate macroeconomic stabilization so the Bank can focus on long-term structural issues; (v) accompanied by Bank assistance to help GOPNG develop a public awareness campaign to widen the consensus for reforms; (vi) concerned with strengthening the civil service as a key element of improved public service delivery; and (vii) supported by an appropriately staffed field office to enable the Bank to build and maintain a close relationship with GOPNG and representatives of civil society and closely monitor the socio-political context of the operation.

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This report was prepared by Asita De Silva (Task Manager), who visited Papua New Guinea in June 1999. Norma Namisato and Betty Casely-Hayford provided administrative support.

Preface

This is the Performance Audit Report (PAR) on the Structural Adjustment Loan (SAL) (Loan 3218-PNG) and the Economic Recovery Program Loan (ERP) (Loan 3934-PNG) to Papua New Guinea.

The SAL was approved on June 5, 1990 for US\$50.0 million. It became effective on October 4, 1990 and was closed on June 30, 1993, twelve months later than planned. The full amount of the loan was disbursed. The ERP loan of US\$50 million was approved on August 29, 1995 and became effective on August 30, 1995. The loan was fully disbursed and closed on December 31, 1996, three months after the planned closing date.

The PAR was prepared by the Operations Evaluation Department (OED). It supplements the Implementation Completion Reports (ICRs) for the two operations and draws on the project files, Bank economic and sector work, government reports, external literature, and interviews with Bank staff. In addition, an OED mission visited PNG in June 1999 to obtain the views of representatives of the government, NGOs, civil society, the private sector, and academia in PNG. The cooperation of all those who contributed to this report is gratefully acknowledged.

Both ICRs were of good quality and identified useful lessons. The PAR develops additional lessons applicable to a proposed structural adjustment loan to PNG that is presently being prepared.

The draft PAR was shared with the Bank team presently preparing a follow-on SAL operation. The Report was sent to the Region and Borrower for comments. Comments received from the Government is attached as Annex C.

Ratings and Responsibilities

Performance Ratings

	<i>Loan 3218</i>	<i>Loan 3934</i>
Outcome	Unsatisfactory	Marginally Satisfactory
Sustainability	Unlikely	Uncertain
Institutional Development Impact	Negligible	Modest
Borrower Performance	Unsatisfactory	Unsatisfactory
Bank Performance	Unsatisfactory	Satisfactory

Key Project Responsibilities

	<i>Loan 3218</i>			<i>Loan 3934</i>		
	<i>TM</i>	<i>Div. Chief</i>	<i>Director</i>	<i>TM</i>	<i>Div. Chief</i>	<i>Director</i>
Appraisal	Z. Qureshi	A. Bhattacharya	R. Cheetham	P. Hamidian-Rad	A. Chhibber	M. Haug
Completion	L. Kenward	A. Chhibber	M. Haug	P. Hamidian-Rad	R. Calkins	M. Haug

ICR prepared by: L. Kenward (L3218); P. Hamidian Rad (L3934)

“In 1991 we had a Structural Adjustment Program. In 1995, we had a Social and Economic Development Program. These two programs were imposed on us from outside. We never fully understood them. We never fully implemented them.”

- Sir Mekere Morauta, Prime Minister of PNG, addressing Parliament in November, 1999

1. Background

1.1 *The PNG context.* Papua New Guinea is a young country with a rich natural resource base but low human development indicators. Its extensive natural endowment includes reserves of gas, copper, gold, and oil; a large fishing zone; fertile soil and favorable climates; extensive tropical forests; large hydropower potential; and attractive sites for tourism development. It has a population of around 4.5 million with a 1998 per capita income of US\$890. Despite its lower-middle income status, however, PNG’s social indicators remain low. Eighty percent of the population is engaged largely in subsistence farming and fishing and has very limited access to basic social services. GDP is estimated to be less than US\$350 per capita in rural areas. Key development constraints include a lack of national cohesion, resulting from a culturally diverse and physically isolated population (that speaks some 800 different languages); high costs of infrastructure provision due to the population’s dispersal across rugged mountains and island archipelagos; an increasingly politicized and ineffective civil service; lack of law and order; a complex system of land ownership that inhibits the use of land; and vulnerability to commodity price shocks and natural disasters.

1.2 *Limited growth realized in the 1980s.* At independence from Australia in 1975, PNG inherited a dual economy, comprising a narrow formal sector focused on mining and plantations and a broad informal sector made up of subsistence agriculture and small-scale cash crop production. The country depended on a large number of expatriates for technical and managerial expertise in both the public and private sectors and imported a high proportion of its consumption basket. Between independence and the late 1980s, conservative economic policies on the part of the government (GOPNG) along with generous aid from Australia helped maintain macroeconomic stability. However, real GDP grew by just 2 percent a year in the 1980s, a level inadequate to increase per capita income. Moreover growth was concentrated in a few activities—gold and copper extraction, commercial timber logging and tree-crop plantations—that had weak linkages with the rest of the economy and limited employment-generating capacity. As a result, by the end of the 1980s, there was stagnant per capita growth in rural areas, rising unemployment in urban areas, and marked regional disparities between areas with mineral resources and those without. Conditions for women in rural areas remained particularly difficult, with women bearing the primary burden for horticultural labor, child-care, collection of water and firewood and having low access to social services and infrastructure.

2. Program Objectives

2.1 *Short-term crises followed by structural adjustment efforts in the 1990s.* The Bank’s US\$50 million Structural Adjustment Loan (SAL) to PNG in FY90 responded to a

macroeconomic crisis that began in the late 1980s. Closure of a large copper mine and lower cocoa production (due to civil unrest in Bougainville) along with a decline in commodity prices upset the balance of payments position and caused a marked decline in GDP in 1989-90. With the support of the SAL, an IMF standby agreement, and grants from EEC, Australia, and Japan, the GOPNG undertook a series of measures to stabilize the economy and to address underlying structural constraints to growth of the non-mining sector. However, after stability was restored, in mid-1992 a new government embarked on an expansionary fiscal and monetary policy that exacerbated the fiscal deficit, expanded domestic borrowing, stimulated inflation, and led to a decline in external reserves to less than 1 month of imports. The Bank's US\$50 million Economic Recovery Program loan (ERP) - essentially a SAL II - was approved in FY95 to help the GOPNG implement a further round of stabilization measures and re-start the structural adjustment effort between 1995 and 1997. This operation was also supported by assistance from the IMF, Australia, ADB, and Japan.

2.2 *Relevance of objectives and instruments.* The specific objectives and measures of both loans are detailed in the ICRs. Both operations supported restoration of prudent short-term monetary and fiscal policies; improving longer-term fiscal management; and rationalizing the trade and price regimes to improve the investment environment. The ERP also included conditions related to improving the forestry regime and protecting social expenditures. The objectives and choice of instruments were appropriate to PNG's circumstances. The need for structural adjustment in PNG remains clear: until the non-mining sector expands most people will be left out of the development process and the economy will be vulnerable to commodity price shocks and the eventual depletion of its mineral resources. Although the ERP loan covered a broad range of sectors, it limited itself to stimulating the early stage of most reforms and it was expected that a follow-on operation in 1996 would advance reforms to their "second stage".

3. Main Achievements

3.1 *Limited sustained achievements under SAL.* The 1990 SAL operation got off to a good start, with all initial stabilization objectives being met and a start made on tax, trade, and fiscal reforms. However, the momentum for reform began to abate in 1992 following a resurgence of mineral revenues that reduced the sense of financial crisis and a change in government in mid-1992. As indicated above, the incoming government began to pursue a misguided expansionary fiscal and monetary policy in the hope of stimulating a non-mineral supply response, leading to a renewed macroeconomic crisis. Moreover, by 1994, trade and tax measures that had been taken under the SAL were reversed; there had been no shift in the composition of expenditures; newly completed expenditure control mechanisms were ineffective; and little progress had been made under the privatization and civil service reform initiatives. The notable exception to the lack of progress beyond 1992 was in de-regulating wages, which was sustained throughout the 1990s.

Table 3.1. PNG: Key Economic Indicators, 1990-1999

<i>Indicator</i>	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 <i>est.</i>	Ave. 80-89	Ave. 90-98*
GNP per capita, (current US\$)	880	940	990	1180	1230	1210	1160	940	890		628	1047
GDP growth (annual %)	-3	9.5	11.8	16.6	5.2	-3.6	3.5	-4.6	1.7	3.9	1.4	4.1
GNP per capita growth (annual %)	-5.1	7.7	3.4	15.5	3.5	-1.9	-0.7	-16	-5.3		-0.9	0.1
Current account balance (% of GDP)	-2.3	-4.1	2.2	12.6	11	18	5.4	-2.8	1.2	5.3	-9.2	4.7
International reserves (months of imports)	3	1.8	1.3	0.9	0.6	1.3	2.6	3.8	1.7	1.1	2.8	1.8
External debt service (% of exports)	37.2	27.2	28.4	28.9	30.8	20.8	12.6	14.3	23.1		22.0	24.8
Inflation, consumer prices (annual %)	7	7	4.3	5	2.9	17.3	11.6	4	13.6	16.1	5.5	8.9
Fiscal balance, incl. grants (% of GDP)	-3.5	-1.9	-5.3	-5.7	-2.2	-0.5	0.5	0.1	-1.4	-1.6	-2.6	-2.2

* Average 1990-99, where available.

3.2 *Better progress seen under ERP, although only the early stages of most reforms were realized.* Under the ERP, tightened fiscal and monetary policies along with better performance in the mineral sector (particularly through growing oil exports) helped contain the fiscal deficit, reduce inflation, and restore external reserves by the end of 1995. Progress was also made in improving the environment for non-mining production through the flotation and subsequent depreciation of the kina; replacement of quantitative trade barriers with tariffs; partial price liberalization; and easing of regulatory obstacles to investment. Other achievements included preparation of a value added tax (eventually implemented in 1999) and larger allocations to the social sectors. The loan also helped improve the GOPNG's oversight function in the forestry sector by strengthening the independent Forestry Authority, introducing monitoring systems for log exports, establishing a code of conduct in logging, and restructuring the revenue system to increase returns to both the GOPNG and landowners. Progress in some of these areas was achieved with great difficulty, however, as the GOPNG's commitment to structural reforms ebbed after stabilization was achieved in 1996. Only with a heavy hand by the Bank and other donors—including the threat of canceling the second tranche—were most of the ERP loan conditions met.

3.3 *External shocks and poor fiscal management disrupted progress after 1997.* After mid-1997, two external factors disrupted the reform effort. The prolonged 1997/98 drought reduced food production as well as mineral and tree-crop exports, while the East Asian crisis caused a drop in timber exports; lower prices for gold, copper, and oil; and a fall in new foreign direct investment (which fell from 7 percent of GDP in 1997 to 2 percent in 1998). In addition, after 1998, the GOPNG's fiscal management deteriorated and combined with a failure to secure external funding, resulted in expanded domestic borrowing that caused inflation to jump to over 16%. Along with a general loss of investor confidence in the GOPNG's management of the economy, the situation deteriorated into a crisis that persists to date.

3.4 *Adjustment efforts failed to stimulate a shift in production structure.* Despite the two Bank loans, a mineral boom, and considerable assistance from other donors, PNG's key development objective of stimulating growth in the non-mineral economy was not achieved in the 1990s. While the mineral sector grew over 15 percent a year in the 1990s, growth in agriculture, fisheries, and forestry (including logging), was just 1.9 percent a year, less than the rate of population growth (2.3 percent). Fisheries remained stagnant at around 2 percent of GDP,

the tourist industry remains severely undeveloped, and a response in agro-processing or manufacturing did not occur. Private fixed investment in the non-mineral sector in the 1990s averaged just 9 percent of GDP, an amount considered by the Bank to be inadequate to cover capital replacement costs. A range of issues remains to be addressed to improve investment and growth in the non-mining sector. These include the lack of infrastructure; lack of clear and consistent policy directions on the part of the GOPNG; continued protectionist biases in the tax, trade, and price regimes; the law and order problem; the land ownership and usage problem; over-regulated air and shipping industries; limited access to finance; and diminution of the competitive environment from public corporations and private monopolies.

3.5 *Lack of a supply response has left the majority out of the development process.*

Temporary successes at stabilizing the economy combined with the exploitation of a succession of new mineral deposits helped PNG achieve a growth rate of over 4 percent a year in the 1990s. However, the narrow base of the growth, combined with ineffective public investment, served to exclude the majority of people in PNG from benefiting from this growth. Estimates indicate that social indicators barely improved over the past decade and remain well below those of similar-income countries. A 1996 survey indicated that 38 percent of the population lived below the poverty line, compared to 11 percent in Indonesia. The Gini coefficient for income in PNG is 0.46, higher than most countries in the region. Life expectancy rose from 56 to 58 years, which is still below the *low-income* country average of 59 years. Adult literacy has remained stagnant at around 52 percent, again below the *low-income* country average of 54 percent. Maternal mortality is very high at 370 per 100,000 births and infant mortality at 79 per 1000 births is well above the regional average of 37. For a lower-middle income country with a GDP per capita of US\$890, these low social indicators reflect the inadequacy of development efforts to date.

4. Evaluation Findings

4.1 *Inconsistent implementation has prevented reforms from taking root.* PNG's implementation of structural policy reforms in the 1990s was highly erratic, with some reforms being espoused but never implemented, others being started and then stopped, and some implemented and then reversed. Examples of the latter include reintroduction of agricultural subsidies in 1992, attempts to reverse tax and trade reforms in 1992 and 1996, and reversal of changes made in the forestry regime in 1998. This experience helped shake investor confidence in the management of the economy and contributed to the lack of supply response. The absence of a supply response in the non-mineral economy, moreover, has meant that periodic successes at stabilization have proved unsustainable.

4.2 *There has been inadequate ownership of the structural reform effort.* Following good initial performance under both loans, implementation was subsequently slowed or reversed. To a large extent, this was the result of wavering political commitment to the reform agenda. While at times strong commitment to reform efforts was shown by both political and bureaucratic leaders, this commitment tended to be (i) confined to a narrow group of people rather than be broadly based (ii) encouraged by the need for immediate relief of a crisis; and (iii) based on only a limited understanding of the issues being advocated by the Bank and donors (see Borrower Comments in ERP ICR). As a consequence, the GOPNG's commitment was easily eroded

following alleviation of the immediate stabilization crisis, by political exigencies, by opposition from interest groups, or by changes in senior officials. The absence of a broad-based and consistent commitment to the reform agenda has been a key factor in frustrating progress to date.

4.3 *The Bank could have done more to help the GOPNG develop an effective public information strategy.* Both Bank operations would have benefited from greater transparency and consensus-building during their design and implementation. Press articles and statements by public officials at the time reflect a perception that the adjustment programs were driven by outside interests rather than those of the people of PNG. Government officials also indicate that the Bank inadequately integrated and disseminated its experiences with adjustment lending in other countries. During implementation of the ERP, the Bank began to engage in dialogue with NGOs and interest groups affected by the reform effort—particularly in forestry—which, to some extent, helped broaden support for reforms. However, these efforts were done by the Bank itself rather than through the government and as a result, caused some discomfort to the GOPNG and mired the Bank in local politics. A more strategic and timely Bank initiative to assist *the GOPNG itself* develop a comprehensive public information strategy—aimed at politicians, the bureaucracy, the media, NGOs, churches, and village/clan groups—is likely to have helped counter the negative image and broaden support for the programs.

4.4 *The Bank's adjustment loans were too ambitious and had too short a time horizon.* Both operations aimed at achieving broad changes in the economy, but yet were expected to be implemented within 1 to 2 years. In retrospect, the extent and expected pace of reform were at odds with the deep-rooted and sociopolitical nature of PNG's development constraints. For example, under the SAL, the rapid timetable helped generate opposition to reforms in the civil service and privatization that eventually prevented any substantial progress from taking place. In addition, as indicated by a recent survey, a key concern for the private sector is policy movement in a consistent direction (i.e. rather than rapid achievements that are then reversed). While it is clear that PNG requires progress across a broad front to achieve its development goals, it is also apparent that it needs to do this gradually but consistently over an extended period.

4.5 *Civil service reform efforts were inadequate.* Although the Bank acknowledged the need for civil service reforms in both adjustment operations, the efforts it supported consisted mainly of wage-bill and staff reduction measures which were not successful, leaving the budgetary burden in place while adversely affecting efforts to build capacity in service departments. This was the case under two parallel investment projects—the Land Reform project and Population and Family Planning project, where efforts to strengthen capacity were undermined by the loss of personnel following civil service cutbacks. In retrospect, given extensive weaknesses in the civil service, greater attention should have been paid to improving management and the incentive framework in the civil service, which are essential for long-term service delivery improvements. The incomplete decentralization efforts, which effectively removed central government responsibility for service delivery but failed to confer resources on local authorities, should have been better addressed. Also, the increasing politicization of the civil service during the 1990s, which adversely affected implementation of reforms warranted attention. Finally, a focus on strengthening anti-corruption and accountability mechanisms in the public sector may also have helped improve efficiency and effectiveness in the public sector.

4.6 *A poor relationship between the Bank and the GOPNG hampered progress.* The relationship between the Bank and the GOPNG was uneven during the 1990s, partly due to the lack of a field presence on the part of the Bank. The distant relationship rendered the Bank unable to convince the incoming government in mid-1992 that pursuit of an expansionary fiscal and monetary was inappropriate. A series of misunderstandings regarding the GOPNG's obligations under ERP and its lack of understanding of the rationale behind some of the loan conditions, resulted in the Prime Minister at the time publicly declaring that "the World Bank can go to hell." During the ERP, both the Bank and the government expected a follow-on operation in 1997 to help consolidate the reforms achieved up to then and enhance the prospects of consistency and sustainability. However, the Bank initially objected to the GOPNG's recruitment of the former Bank country economist for PNG and subsequently the GOPNG was less inclined to work with the Bank. As a consequence, little substantive dialogue on the next stages of the reform program took place in 1998/99.

4.7 *Incomplete implementation has had its costs.* The incomplete and inconsistent progress on the reform agenda meant that some of the short-term costs of adjustment were incurred, without off-setting long-term benefits. As an example, the sustained depreciation of the *Kina* after 1996—while improving the incentives for exports—also adversely affected urban consumers and established import-oriented businesses. The expected compensating supply response in agriculture and manufactured exports did not occur, however, due to the existence of a range of other obstacles to private sector activity—including poor infrastructure; low investor confidence due to unclear and inconsistent policy directions; continued protectionist biases in the tax, trade, and price regimes; limited access to finance; and diminution of the competitive environment from public corporations, marketing boards, or private monopolies. This factor can threaten the sustainability of reforms achieved to date as political pressure from vocal adversely affected groups mounts.

4.8 *Parallel efforts on other fronts are required for a successful structural adjustment effort.* In the 1990s, little progress was made in addressing severe deficiencies in infrastructure, the law and order problem, the land ownership problem, corruption, low levels of education and skills, and the security situation in Bougainville. These factors, while outside the realm of Bank adjustment lending, remain key obstacles to a broad-based private sector supply response in the non-mineral sectors. Progress in alleviating these constraints is likely to be required before the desired shift in production structure takes place.

5. Performance Ratings

Table 5.1. PAR Performance Ratings

Rating	SAL	ERP
Outcome	Unsatisfactory	Marginally Satisfactory
Institutional Development	Negligible	Modest
Sustainability	Unlikely	Uncertain
Bank Performance	Unsatisfactory	Satisfactory
Borrower Performance	Unsatisfactory	Unsatisfactory

5.1 **Outcome.** The PAR agrees with the ICR of the SAL on an *unsatisfactory* outcome rating for the SAL. Other than in a very few areas, the operation did not have a significant lasting impact on the country. The outcome of the ERP operation is rated *marginally satisfactory* rather than satisfactory as stated in the ICR. The operation was able to achieve its limited objective of stimulating the early stages of several key reforms between 1995 and 1997. However, with few follow-on actions, some reversals, a series of external shocks, and ineffective fiscal management after 1997, the longer-term benefits of the program have been limited.

5.2 **Institutional Development (ID) Impact.** The PAR rates ID impact as *negligible* under the SAL and *modest* under the ERP, in agreement with both ICRs. A key ID objective of the SAL, was to establish a central policy-making and coordinating body, although this body failed to ever meet. The privatization and civil service reform initiatives of the SAL failed to take root and while the SAL helped establish the Investment Promotion agency, this institution suffered from managerial weaknesses throughout the 1990s and has not become an effective body. The ERP efforts to support implementation of the Provincial and Local Government Reform program were not successful: the central government transferred to local governments the responsibility, but not the resources for service delivery. However, the ERP operation did generate debate and awareness that helped build a new constituency within the private sector and sections of the political and bureaucratic leadership for resuming the structural reform effort.

5.3 **Sustainability.** The PAR agrees with the ICR sustainability ratings of *unlikely* for the SAL and *uncertain* for the ERP. With the exception of the GOPNG's success in liberalizing the wage regime, there were few other lasting achievements of the SAL. Under the ERP, several reforms have been sustained, particularly management of a floating exchange rate, removal of quantitative trade barriers, and liberalization of some price controls. However, macroeconomic stability has not been sustained, due to both weak fiscal management after 1997 as well as prolonged external shocks arising from the drought and the East Asian crisis. Moreover, there were setbacks in the form of efforts to reintroduce trade barriers in 1996 and the reversal of reforms in the forestry sector in 1998. The present government has demonstrated commitment to the principles embodied in the SAL and ERP programs and has begun implementing a broad reform program.

5.4 **Bank Performance.** The PAR rates Bank performance *unsatisfactory* under the SAL and *marginally satisfactory* under the ERP. Both operations suffered from unrealistic assessments as to the likely pace and extent of reforms given the GOPNG's capacity limitations and a limited social consensus for the reform programs. Supervision of both loans was relatively intensive, although absence of a full time Bank representative in the country reduced the consistency of the dialogue. During the ERP, the Bank delayed release of the second tranche due to government delays in implementing reforms in forestry and trade. While this soured the relationship between the Bank and the GOPNG at the time, it sent a strong message on the Bank's commitment to helping stimulate structural reforms and ensured that the major elements of the reform program were implemented. The experience lifted the image of the Bank among reformist elements and other donors in the country and has given it a leadership position in helping set the policy reform agenda. At present, all major donors have made their future assistance conditional on the government's reaching an agreement with the Bank on a structural reform program.

5.5 Borrower Performance. The PAR rates Borrower performance under the two loans as *unsatisfactory*. While the government implemented and sustained some difficult reforms, there was a lack of overall commitment to the spirit of the reform agenda. The Borrower did not fully implement the range of agreed reforms under the loans; some reforms that were implemented were subsequently reversed; and some were implemented only following the Bank's threat of suspending additional financing. Government performance was partly undermined by factors beyond its immediate control - external shocks, frequent changes in government, and the lack of social consensus on the direction of reforms constrained its ability to fully implement the programs. At the same time, however, adverse government actions undermined the civil service's ability to implement program components; effective fiscal management needed to support the program was absent; there was inadequate interaction and coordination between key responsible agencies; needed efforts to strengthen local governments in order to enhance implementation capacity did not occur. While individuals within the political and bureaucratic leadership periodically displayed strong commitment to the reform agenda, this commitment appears to have been insufficiently broad-based and informed to yield adequate and sustained progress on the agenda.

6. Recommendations

6.1 The Bank is presently designing a follow-on structural adjustment loan to PNG that is expected to be approved in 2000. Lessons from the Bank's past experience with adjustment lending in PNG applicable to this proposed operation include:

- *Broad ownership of the reform agenda should be ensured.* During the 1990s, several incoming governments avowed commitment to reforms and made the right initial moves, but eventually failed to sustain these efforts. Reform commitments tended to be made by a narrow circle of public sector officials and lacked broad-based support. Moreover, even among these officials, there appears to have been only limited appreciation of the purpose of reforms. Ownership of the reform agenda is essential to ensure sustained implementation during both hard and good times.
- *Adjustment lending to PNG should be undertaken only in the context of progress in addressing a broad front of sociopolitical constraints.* Stimulating the desired supply response is likely to require parallel efforts aimed at improving governance, civil service reform, improving law and order, political reform, land reform, and consensus-building at the village/clan level. Future adjustment lending should be part of a much wider reform effort that begins to redress these issues.
- *Future adjustment programs should aim to achieve gradual, consistent implementation of reforms over an extended period.* In retrospect, an overly ambitious and fast-paced reform agenda in the past generated opposition that helped inhibit substantial progress from taking place. A key concern for the private sector, moreover, is policy movement in a consistent direction, rather than rapid achievements that are then reversed.
- *Close collaboration with other development partners should be ensured so that the Bank can focus on longer-term structural reform.* Both Bank-funded operations in the 1990s were

implemented during periods of macroeconomic crisis and as a consequence focused on short-term stabilization issues. Future adjustment lending should be done within a comprehensive development framework with other partners to ensure that Bank operations can focus on longer-term obstacles to changes in the production structure.

- *The government should be assisted in developing a public awareness campaign to broaden the consensus for reforms.* The Bank should encourage the GOPNG take the lead in developing a public awareness campaign, encompassing village-level groups, political leaders, the civil service, religious leaders, the press, the private sector, and NGOs in order to broaden understanding of the costs and benefits of structural adjustment and build public support.
- *A focus on improving incentives in the civil service is necessary to expand access to key public services.* The elusive supply response is unlikely to be realized in the absence of expanded access to infrastructure in rural areas. A critical obstacle to expanding infrastructure access in the past has been poor performance among key public agencies, including the Department of Works. These public agencies need restructuring and incentives to improve the delivery of services.
- *The Bank should maintain a close relationship with the GOPNG and civil society and develop full awareness of the social, political, and cultural implications of adjustment operations.* An appropriately staffed field office in PNG, which has been absent in the past, is likely to enhance this end.

Basic Data Sheet

STRUCTURAL ADJUSTMENT LOAN (LOAN 3218-PNG)

Key Project Data (amounts in US\$ million)

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Loan amount	50	50	100

Cumulative Estimated and Actual Disbursements

	FY91	FY92	FY93
Appraisal estimate (US\$M)	50	50	50
Actual (US\$M)	25	49	50
Actual as % of appraisal	50	98	100
Date of final disbursement:	January 8, 1993		

Project Dates

	<i>Original</i>	<i>Actual</i>
Identification		11/89
Appraisal		2/90
Negotiations	4/90	4/90
Letters of Development Policy	4/27/90	4/27/90
Board approval	6/5/90	6/5/90
Loan agreement		8/24/90
Effectiveness	7/90	10/4/90
Closing date	6/30/92	6/30/93

Annex A

Mission/Staff Inputs (staff weeks)

	<i>Month/year</i>	<i>No. of persons</i>	<i>Staff weeks</i>	<i>Date of report</i>
Preparation*	late 1989	5	17.1	...
Appraisal	2/90	5	11.3	3/6/90
Negotiations	4/90	9	6.4	5/7/90
Supervision	9/90	6	14	10/5/90
Supervision	12/90	1	1	1/2/91
Supervision	4/91	1	2	4/25/91
Supervision	8/91	1	1.5	...
Supervision	11/91	1	1	12/5/91
Tranche release	12/91	1	2	12/18/91
Completion	3/93	1	4	

* Prior to Feb. 1990, the PNG SAL was not a separately identified task; preparations were incorporated in the November 1989 CEM mission.

Other Project Data

Borrower/Executing Agency: Ind. State of Papua New Guinea

<i>FOLLOW-ON OPERATIONS</i>			
<i>Operation</i>	<i>Loan no.</i>	<i>Amount (US\$ million)</i>	<i>Board date</i>
Economic Recovery Program	3934	50	8/29/95

Basic Data Sheet

ECONOMIC RECOVERY PROGRAM (LOAN 3934-PNG)

Key Project Data (amounts in US\$ million)

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Loan amount	80	50	63
Cofinancing	202	139	69

Cumulative Estimated and Actual Disbursements

	<i>FY96</i>	<i>FY97</i>
Appraisal estimate (US\$M)	50	50
Actual (US\$M)	25	50
Actual as % of appraisal	50	100
Date of final disbursement:	January 1997	

Project Dates

	<i>Original</i>	<i>Actual</i>
Identification	10/2/94	10/2/94
Preparation	2/95	2/95
Preappraisal	3/28/95	3/28/95
Appraisal	7/15/95	7/15/95
Negotiations	7/24/95	8/4/95
Letters of Development Policy	7/24/95	8/7/95
Board approval	8/29/95	8/29/95
Signing		8/30/95
Effectiveness	9/95	8/30/95
Completion	9/96	1/97
Closing date	9/30/96	1/15/97

Annex A**Staff Inputs** (staff weeks)

	<i>Planned</i>	<i>Actual</i>
Preparation to Appraisal	..	59.9
Appraisal	..	0.6
Negotiations through Board Approval	..	3.6
Supervision	35.0	112.5
Total	35.0	176.6

Mission Data

<i>Status of project cycle</i>	<i>Month/Year</i>	<i>No. of persons</i>	<i>Days in field</i>	<i>Specialization¹</i>	<i>Performance Rating²</i>	
					<i>Implementation Status</i>	<i>Development Objectives</i>
Through Appraisal	7/95	3	50	E/RP	--	--
Appraisal through Board approval	8/95	4	15	E/RP	--	--
Board approval through Effectiveness	8/95	--	--	--	--	--
Supervision 1	2-3/96	8	14	E/RP	3	3
Supervision 2	5-6/96	8	18	E/RP/L/F/I/A	3	3
Supervision 3	7/96	8	12	E/RP/FA/L/C	2	3
Supervision 4	9/96	4	5	E/F/A/FA/C	3	3
Supervision 5	10-11/96	5	24	E/F/FA/C/EX	2	2

1 Specialization

A = Anthropologist
 C = Consultant
 E = Economist/Macro.
 EX = External Affairs Spec.
 F = Financial Specialist
 FA = Forestry Advisor
 I = Information Officer
 L = Legal Counsel
 RP = Research/Prog. Analyst

2 Performance rating

1 = Highly satisfactory
 2 = Satisfactory
 3 = Unsatisfactory
 4 = Highly unsatisfactory

Annex B: Statistical Information

Table 1. Key Economic Indicators: PNG and Comparator Countries, 1988-1997

Table 2. Changes in the Structure of Production

Table 3. Composition of Exports

ANNEX TABLE 1: KEY ECONOMIC INDICATORS: PAPUA NEW GUINEA AND COMPARATOR COUNTRIES, 1988-1997

<i>All figures are annual averages for the period 1988-1997</i>	PNG	Cambodia	Fiji	Indonesia	Lao	Malaysia	Mongolia	Philippines	Thailand	Vietnam	EAP	SSA	SAR
GDP growth (annual %)	3.6	5.5	3.1	7.6	7.4	8.8	0.0	3.8	8.5	7.7	8.6	2.2	5.7
GNP per capita growth (annual %)	0.5	2.5	1.9	6.0	4.7	5.9	-1.0	1.9	6.8	5.1	7.0	-0.5	3.8
GNP per capita, Atlas method (current US\$)	1043	218	2117	804	311	3105	353	870	2052	240	646	522	342
Agriculture, value added (% of GDP)	27	52	20	19	57	16	27	21	12	33	21	18	29
Industry, value added (% GDP)	36	14	24	40	18	41	35	33	38	28	42	35	28
Manufacturing, value added (% of GDP)	9	6	11	22	13	28	0	24	28	21	31	17	18
Services, etc., value added (% of GDP)	36	34	57	41	25	43	39	45	50	39	37	47	43
Exports of goods and services (% of GDP)	49	16	58	26	18	83	45	33	38	31	26	29	11
Imports of goods and services (% of GDP)	49	26	58	25	33	82	57	39	42	38	26	29	15
International tourism, receipts (% of total exports)	2	14	25	9	8	4	2	11	12	2	7	5	6
Trade (% of GDP)	97	42	116	51	52	165	102	72	80	69	53	57	26
Agriculture, value added (annual % growth)	3	4	1	3	4	3	5	2	4	5	4	3	4
Industry, value added (annual % growth)	6	8	5	10	13	11	-1	4	11	9	12	2	7
Manufacturing, value added (annual % growth)	3	8		11	15	14		4	11	..	12	1	7
Services, etc., value added (annual % growth)	3	7	2	8	6	9	-1	4	8	7	8	2	7
Aid (% of central government expenditures)	29		12	7		1	94	11	4				
Aid (% of GNP)	9	14	3	1	19	0	24	2	1	7	1	8	2
Aid (% of gross domestic investment)	37	107	23	4	107	1	100	9	2	50	4	47	7
Aid per capita (current US\$)	92	30	66	9	52	5	131	16	12	14	5	34	5
Gross domestic savings (% of GDP)	25	4	14	32	8	38	19	17	35	14	36	17	19
Gross domestic investment (% of GDP)	25	14	14	30	25	37	31	23	39	21	35	18	23
Gross international reserves in months of imports	1.8	1.7	3.5	3.2	1.6	3.8	2.7	2.6	4.7	1.5	3.9	1.4	3.7
Private investment (% of GDFI)	82	79	44	67	..	67	..	81	79	79	54	64	62
Foreign direct investment, net inflows (% of GDI)	17	18	21	5	15	16	4	7	5	17	8	8	2
Credit to private sector (% of GDP)	25	5	36	47	6	107	13	34	106	7	80	57	26
Domestic credit provided by banking sector (% of GDP)	33	7	41	46	9	116	27	45	110	21	84	72	50
Inflation, consumer prices (annual %)	6.9		5.2	8.1		3.6		10.1	5.1	..			
Money and quasi money (M2) as % of GDP	32	9	48	38	11	76	21	38	69	20			
Money and quasi money growth (annual %)	11	34	9	26	35	18	72	23	18	23			
Tax revenue (% of GDP)	19		21	16		20	19	15	16				
Taxes on goods and services (% of current revenue)	11		24	28		22	23	27	42		26	25	35
Taxes on international trade (% of current revenue)	25		26	5		15	13	25	18		16	28	26
Military expenditure (% of central government expenditure)	5		7	8	22	11	10	11	17	22			
Pupil-teacher ratio, primary	33	42	31	23	29	20	26	34	21	0	23	41	62
School enrollment, primary (% gross)	75	122	125	115	107	98	88	111	95	107	118	76	95
Illiteracy rate, adult total (% of people 15+)	38		10	17		16		6	6	9	18	45	51
Immunization, measles (% of children under 12 months)	63	48	81	84	50	77	85	85	72	90	89	51	77
Life expectancy at birth, total (years)	57	53	74	65	53	74	65	69	72	70	70	52	61
Mortality rate, infant (per 1,000 live births)	26			54		56		44	..	75	57	19	33
Safe water (% of population with access)	27	13	75	65	39	86	77	79	81	44	74	47	81
Sanitation (% of population with access)	21		85	55	17	88	100	76	80	61	..	47	20
Population density (people per sq km)	9	52	42	102	18	58	1	220	112	213	104	23	245
Population growth (annual %)	2.3	2.9	1.2	1.7	2.5	2.7	2.2	2.4	1.4	2.2	1.4	2.8	2.0
Urban population (% of total)	16	19	40	33	19	52	59	51	19	20	30	30	25

Source: WDI, 1998

ANNEX TABLE 2: CHANGES IN THE STRUCTURE OF PRODUCTION										
	1990	1991	1992	1993	1994	1995	1996	1997	1998	Average 1990-1998
Sectoral Growth Rates (% Change)										
Agriculture, Forestry, and Fishing	2.2	-2.6	6.1	9.5	4.6	2.1	6.1	-4.2	-6.4	1.9
Mining and Quarrying	22.8	41.9	8.5	-4.6	0.9	-2.9	-24.7	-14.7	59.5	9.7
Petroleum				215.1	-5.2	-14.8	6.2	-28.8	8.4	30.1
Manufacturing	-22.8	15.8	8.0	1.6	7.2	-1.6	14.7	5.2	-0.1	3.1
Electricity, Gas, and Water	0.0	5.5	4.1	-2.0	6.9	-0.5	6.0	-0.2	5.2	2.8
Construction	-8.6	33.0	-8.0	-12.9	21.0	-27.8	69.1	-7.9	18.3	8.5
Trade, Transport, Finance	-9.4	15.2	1.5	4.8	9.2	-0.5	8.6	6.9	-1.4	3.9
Community and social services	-2.7	-0.6	5.0	5.7	10.3	-2.7	-7.8	5.0	-10.0	0.2
Real GDP growth	-3.0	9.5	11.8	16.6	5.2	-3.6	3.5	-4.6	2.5	4.2
Sectoral Share of GDP (%)										
Agriculture, Forestry, and Fishing	34.2	30.4	28.8	27.1	26.9	28.5	29.2	29.3	26.8	29.0
Mining and Quarrying	11.8	15.3	14.8	12.1	11.6	11.7	8.5	7.6	11.9	11.7
Petroleum	0.0	0.0	6.5	17.5	15.8	14.0	14.3	10.7	11.3	10.0
Manufacturing	8.2	8.7	8.4	7.3	7.5	7.6	8.4	9.3	9.1	8.3
Electricity, Gas, and Water	1.6	1.5	1.4	1.2	1.2	1.2	1.3	1.3	1.4	1.3
Construction	4.6	5.6	4.6	3.5	4.0	3.0	4.9	4.7	5.4	4.5
Trade, Transport, Finance	17.7	18.6	16.9	15.2	15.7	16.2	17.0	19.1	18.4	17.2
Community and social services	16.4	14.9	14.0	12.6	13.2	13.4	11.9	13.1	11.5	13.4
GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Sectoral Distribution of Employment (% of Total Employment)										
Retail	6.0	6.1	5.8	5.7	5.7	6.3	6.1	6.7	7.3	6.2
Wholesale	2.2	2.1	2.2	2.1	2.1	2.1	1.9	2.0	2.0	2.1
Manufacturing	8.1	8.3	8.6	8.8	9.6	9.3	9.1	9.5	9.5	9.0
Building and Construction	12.8	9.9	9.1	8.7	8.7	8.3	9.9	9.6	8.5	9.5
Transportation	6.6	6.3	5.5	5.3	5.3	5.3	5.4	5.5	5.6	5.6
Agriculture, Forestry, and Fishing	27.5	28.3	29.8	29.1	29.2	26.7	26.3	24.1	21.1	26.9
Financial and Business	5.0	4.8	4.8	4.7	4.3	5.0	4.9	5.4	6.0	5.0
Other	8.1	8.8	8.8	9.0	9.2	10.8	10.8	11.0	11.2	9.7
Total Non-Mineral Sectors	76.3	74.6	74.5	73.5	74.0	73.7	74.5	73.6	71.3	74.0
Total Mineral Sector	2.3	2.3	2.4	2.4	2.2	2.5	2.5	2.5	3.1	2.5
Total Public Sector	21.4	23.0	23.1	24.1	23.8	23.8	23.1	23.8	25.7	23.5
Total Private Sector	78.6	77.0	76.9	75.9	76.2	76.2	76.9	76.2	74.4	76.5
Total Employment	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Fixed Investment as a Share of GDP (%)										
Total Fixed Investment	25.1	28.0	23.3	18.1	14.5	19.4	27.9	27.1	30.3	23.7
Public Investment	5.1	4.7	5.1	4.3	2.8	3.6	3.7	5.4	6.9	4.6
Private Investment	20.0	23.3	18.2	13.8	11.6	15.7	24.2	21.6	23.3	19.1
Mining	11.4	15.9	10.8	4.7	2.1	7.2	15.3	12.1	14.5	10.4
Non-mining	8.6	7.4	7.4	9.1	9.5	8.6	8.9	9.5	8.9	8.7
GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<i>Source: World Bank</i>										



DEPARTMENT OF FINANCE AND TREASURY
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P O BOX 710, WAIGANI
Papua New Guinea

June 6, 2000

Mr Ruben Lamdany
Manager
Country Evaluations and Regional Relations
Operations Department
International Bank for reconstruction and Development
1818 H Street, N.W.
Washington D.C. 20433
U.S.A.

Dear Mr Lamdany,

**SUBJECT: PAPUA NEW GUINEA: STRUCTURAL ADJUSTMENT
LOAN AND ECONOMIC RECOVERY PROGRAM: DRAFT
PERFORMANCE AUDIT**

Thank you for the copy of the Draft Performance Audit. The Department of Finance and Treasury have reviewed the report and comments are provided in this letter. The findings and recommendations of the report are timely, since the Government of Papua New Guinea has recently concluded negotiations for a Governance Promotion Adjustment Loan (GPAL) from the World Bank.

The Department of Finance and Treasury agrees that Papua New Guinea's development indicators have been disappointing. However, in carrying out any appraisal of the performance of programs it is difficult to identify a direct causality. In particular, there is a risk of attaching too much significance the performance in implementing structural reform initiatives on overall economic performance. Notably, the Papua New Guinean economy was subjected to a number of external shocks during this period; the Asian Crisis, low commodity prices and a prolonged drought. Although poor economic management no doubt exacerbated the effects of these, it was not the only reason for the poor performance of development indicators. It is worth noting that with the re-introduction of sound economic management, a greater emphasis on restoring integrity to the process of Government and the improving external outlook, it is

expected that there will be strong economic growth in 2000 and 2001 (4.6% and 5.9% respectively).

Furthermore, whilst the Department of Finance and Treasury agrees that there has been a failure to implement the full range of promised reforms, it should be noted that on the whole there has been forward movement on a broad range of measures, despite slippage along the way. Successes should therefore be noted as well as failures. In particular there was progress in implementing a number of significant reform measures; notably Tariff Reform and the introduction of VAT.

The Department of Finance and Treasury agrees that it is important to have strong ownership of the proposed World Bank programs. It should be noted that the reform measures, upon which the proposed GPAL is conditional, are based upon the Government's own structural reform agenda. This was developed through a consultative process, articulated at a Consultative Group meeting with bilateral and multilateral donors in November 1999 and formalised in the 2000 Budget in December 1999.

The Department of Finance and Treasury agrees that structural reform must take place within the context of addressing broader socio-political constraints. A key focus of the current reform agenda is improving governance. This reflects a recognition of the key socio-political constraints that have hampered structural reform in the past. In particular a number of steps have been taken to restore integrity to the process of government. These include: the strengthening of central agencies, the restoration of a formalised policy process, the setting up of a Central Agencies Co-ordinating Committee, the strengthening of watchdog agencies and investigation of high level corruption cases (notably the National Provident Fund Commission of Inquiry).

The Department of Finance and Treasury agrees that longer-term structural reform needs to be carried out in collaboration with other development partners. As noted above, the Government's structural reform agenda was produced in consultation with a number of bilateral and multilateral partners. A Friends of Papua New Guinea Group was established at APEC at the end of 1999 to provide assistance to PNG and steps have been taken to re-established and strengthen relations with the World Bank, IMF and Asian Development Bank. The result has been that there is strong participation from all of these groups in implementing the Government's structural reform agenda.

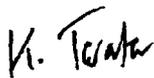
The Department of Finance and Treasury agrees that there is a need to develop greater public awareness and to develop a broad based consensus for reforms. The Government has been keen to promote the Consultative Implementation and Monitoring Council (CIMC). This consists of a number of sectoral sub-committees, comprising NGOs, industry representatives and Government officials, which meet regularly

to discuss and recommend development policies. The work of the CIMC culminates each year in a two day development forum and the submission of recommendations to the National Executive Council. Furthermore, in 1999 and 2000, moves have been made to increase the participation in this process by conducting fora in the provinces.

The Department of Finance and Treasury agrees that it is important to improve incentives in the civil service. Recognising this, the Government has commenced a review that will lead to strengthening of the role of the Public Services Commission. This aims to bring hiring, dismissal and remuneration back more directly within the ambit of the public service and reduce political discretion in these areas. The Government is also carrying out functional reviews of key Government agencies (including the Department of Works) in order to improve the delivery of services.

I would like to take this opportunity to thank you and your staff for the work that has gone into producing the Draft Performance Audit. The findings and recommendations are useful. This kind of constructive critical appraisal is important in terms of highlighting strengths and weaknesses and ultimately improving upon previous performance. Although the overall conclusions on the performance of the loans seem quite pessimistic, I hope that the performance of the Government, since mid 1999, goes some way to demonstrate the seriousness in advancing the structural reform agenda.

Yours sincerely



KOIARI TARATA, ISO

Secretary