



Australian Government
AusAID

Economic governance

ANNUAL THEMATIC PERFORMANCE REPORT 2006–07

FEBRUARY 2008

www.ausaid.gov.au

© Commonwealth of Australia 2008

This work is copyright. You may download, display, print and reproduce this material in unaltered form only (retaining this notice) for your personal, non-commercial use or use within your organisation. Apart from any use as permitted under the *Copyright Act 1968*, all other rights are reserved. Requests and inquiries concerning reproduction and rights should be addressed to Commonwealth Copyright Administration, Attorney General's Department, Robert Garran Offices, National Circuit, Barton ACT 2600 or posted at <http://www.ag.gov.au/cca>

ISBN 978-1-921285-09-7

Published by the Australian Agency for International Development (AusAID),
Canberra, February 2008.

This document is online at www.aid.gov.au/publications

For more information about the Australian overseas aid program, contact:

Public Affairs Group

AusAID

GPO Box 887

Canberra ACT 2601

Phone (02) 6206 4000

Facsimile (02) 6206 4695

Internet www.aid.gov.au

Contents

PREFACE	4
SUMMARY	5
1 THE STATE OF ECONOMIC GOVERNANCE IN THE ASIA-PACIFIC	7
2 PROGRESS AGAINST AUSTRALIA'S POLICY OBJECTIVES	10
2.1 Policy objectives	10
2.2 Expenditure by objective and country	10
2.3 Major initiatives	12
2.4 Performance and achievements	14
3 LESSONS	16
3.1 The appropriate focus of economic governance assistance	16
3.2 The effectiveness of economic governance technical assistance	18
3.3 Alternative approaches: the use of performance-based partnerships	23
ACRONYMS AND ABBREVIATIONS	24
FIGURE	
1 Quality of macroeconomic and microeconomic policies in the Asia-Pacific region (CPIA scores)	8
TABLES	
1 Government effectiveness rankings, Pacific and East Asia, from 1 (worst) to 100 (best)	7
2 Australian ODA for economic governance, 2006–07, by objective	11
3 Australian ODA for economic governance, by country	11
4 Major economic governance initiatives assessed, 2006–07	15

Preface

Annual thematic performance reports are among the major new performance assessment mechanisms introduced by AusAID.

Starting in 2007, AusAID will produce an *Annual review of development effectiveness*, informed by annual program performance updates for country and regional programs, and for key sectors and themes.

The purpose of the annual thematic performance reports is to describe progress against AusAID's policy objectives (including regional progress on the Millennium Development Goals), to identify current challenges in aid delivery and to highlight lessons to inform future investments.

The annual thematic performance reports aim to highlight key issues in aid delivery, focusing on the past 12–18 months, rather than to present a comprehensive analysis of all activities.

Four annual thematic performance reports were produced for 2006–07: for health, education, gender and economic governance. As this year was a pilot, these four reports are all structured slightly differently.

The four reports were prepared by the relevant thematic group within AusAID, under the leadership of the relevant adviser for that thematic area. The reports were all peer reviewed by a combination of internal and external experts.

Summary

Improving economic governance is an important objective for the Australian aid program. Some \$170 million was spent towards the achievement of this objective in 2006–07. Assessing its effectiveness is problematic because of the difficulty of quantifying benefits and attributing them to the aid program. However, the portfolio is performing strongly overall with 93 per cent of economic governance projects considered to be achieving their objectives.

Many countries in the Pacific continue to have low governance indicators. The disjunction between resources and results requires ongoing examination of Australia's interventions. This report analyses how the Australian Government can improve the effectiveness of spending on technical assistance, which predominates in the economic governance aid portfolio.

Key partner governments show worse performance on the microeconomic than the macroeconomic policy front and are struggling to effectively expend available resources. Australia's technical assistance effort in the area of economic governance needs and is starting to take opportunities as they arise to give more emphasis to microeconomic reform and to improving expenditure prioritisation and quality. More focus also needs and is starting to be given to reform and budget implementation relative to planning and preparation. Financial controls are being strengthened to cut down on corruption and waste, but implementation capacity needs to be strengthened to enable budgeted expenditures to actually be incurred.

Country ownership is essential to effective technical assistance, and generally a good job is done of ensuring this in the area of economic governance. The aim should continue to be to support 'good enough governance'.

Australian technical assistance in the area of economic governance has traditionally been delivered by consultants but is now increasingly being delivered by Australian public servants (deployees). There are successful examples of both models. Looking forward, both models are likely to be used in the future in major partner countries in the area of economic governance. This will require greater emphasis on coordination and harmonisation of efforts within the Australian aid program, and on consideration of areas of comparative advantage.

Technical assistance in the area of economic governance should be assessed against the twin objectives of building capacity in the area of economic governance (*building*) and directly undertaking economic governance tasks (*doing*). Both are important, but to differing degrees in different contexts. A recent review of economic technical

assistance in the Pacific found that 'country officials, mainly at a high level, were over-burdened with visits by staff of international and bilateral agencies and their consultants on TA assignments'. More coordination between donors will help address this problem. More fundamentally, this finding suggests that Pacific governments need more help with *doing* to be able to absorb the considerable amount of advisory assistance available to them. It needs to be recognised that small and very poor states will need to import skilled staff in some areas for a long time, perhaps indefinitely. This should be balanced by clearer identification of areas where local capacity can be strengthened and empowered.

Different technical assistance instruments have very different unit costs. A variety of instruments should be considered, and more weight given to cost-effectiveness considerations in determining the optimal mix of technical assistance support for economic governance.

Although there can be no substitute for government reform leadership, technical assistance can be an effective mode of supporting economic governance even in environments which overall are not supportive of reform efforts. It is important, however, to be realistic about what technical assistance can and cannot achieve, given political constraints.

While technical assistance has been the dominant mode of assistance for improving economic governance, alternatives to technical assistance should be given greater consideration. An alternative, which shows initial promise in the Australian aid program and which may warrant expansion, is the use of funding to provide incentives for better governance.

1 The state of economic governance in the Asia–Pacific

‘Economic governance’ refers to the policy and regulatory settings that governments adopt to manage the economy. Economic governance encompasses two broad areas of public policy: macroeconomic (including aggregate fiscal) management and microeconomic management (relating to the policies that determine the private-sector operating environment, including business licensing procedures and contract enforcement processes).

Across the Pacific, weak economic management continues to be a key constraint to economic development. In Asia, governments are more effective and stable. However, many market reform challenges remain, and corruption is an ongoing challenge. Transparency International’s 2006 Corruption Perceptions Index rated Indonesia, the Philippines, Laos and Cambodia in the second-lowest decile.

The World Bank’s Worldwide Governance Indicators (WGIs) provide a measure of economic governance performance across nearly all of AusAID’s partner countries, since 1996. The country scores for each indicator are the result of a range of surveys done by a number of international organisations. In general, Australia’s partner countries rank in the lower half on economic governance measures, though a great deal of variation is evident. Table 1 shows the ranking of partner countries on the criterion of government effectiveness, one of the six WGI indicators. (Note that 1 is the worst possible ranking, 100 the best possible; 212 developing and developed countries are ranked in total.)

Table 1 Government effectiveness rankings, Pacific and East Asia, from 1 (worst) to 100 (best)

	1996	1998	2000	2002	2003	2004	2005	2006
Pacific								
Samoa	45	54	58	65	66	61	65	57
Tonga	53	36	34	28	33	28	36	29
Papua New Guinea	31	29	27	22	25	24	17	23
Solomon Islands	11	19	17	3	1	3	30	18
Vanuatu		36	35	44	17	28	45	40
Fiji	57	55	46	61	56	41	53	52
East Asia								
China	67	48	56	60	58	57	53	55
Indonesia	64	21	35	33	32	39	37	41
Philippines	60	50	49	55	56	49	55	55
Vietnam	53	31	39	40	42	40	46	42
Cambodia	9	19	21	25	23	19	18	15
Laos	58	25	21	26	12	15	13	19
East Timor				15	16	21	15	27

Note: The numbers indicate the percentile ranking of the various countries out of a total of 212 countries.

Source: <http://info.worldbank.org/governance/kkz2005>

Papua New Guinea (PNG) – Australia’s second largest aid recipient – is of particular concern. It rates among the lowest in the Asia–Pacific in terms of government effectiveness.

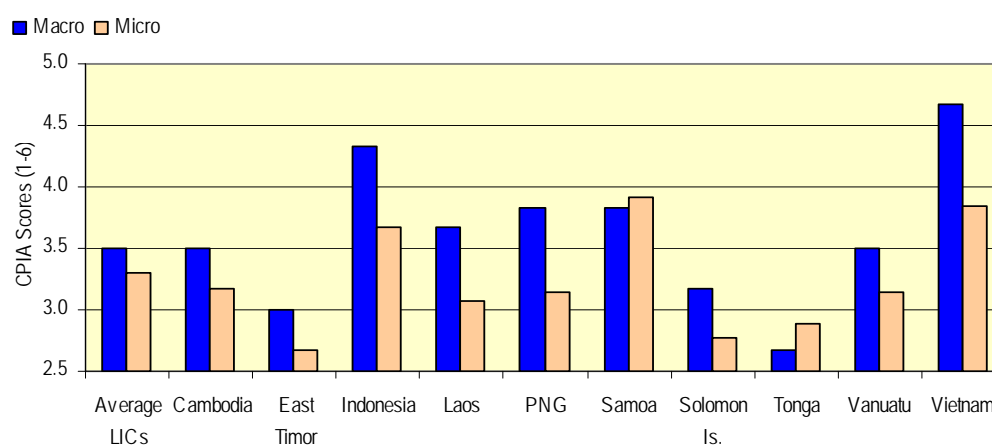
There are, however, success stories. In recent years, Samoa has recorded steady improvements in government effectiveness rankings. It now ranks significantly above the average for East Asia. Both Vanuatu and Solomon Islands have also recently improved their rankings on government effectiveness, Solomon Islands after hitting rock bottom at the time of the civil strife of 2003.

Government effectiveness scores for Asian countries are generally higher, though not for Cambodia, Laos and East Timor. Indonesia shows significant improvement following a sharp decline during the time of the East Asian crisis.

Governance indicators are also available from the World Bank’s Country Policy and Institutional Assessment (CPIA) as well as the Asian Development Bank’s Country Performance Assessment (CPA), but these do not provide a time-series.¹

A distinctive feature of the region is the significantly better quality of macroeconomic than microeconomic policies. This is a feature of the developing world as a whole. The World Bank CPIA rates developing countries a 3.5 (out of 5) for their macro policies, but only 3.3 for micro policies (public sector management and structural policy).² But the gap is much greater in the Asia–Pacific region, as Figure 1 shows.

Figure 1 Quality of macroeconomic and microeconomic policies in the Asia–Pacific region (CPIA scores)



Note: CPIA = (World Bank) Country Policy and Institutional Assessment; LICs = low-income countries. In CPIA scores, countries are rated on a scale of 1 (low) to 6 (high) on 16 criteria.

Source: World Bank.

¹ The 2005 CPIA scores are broadly congruent with the WBI rankings. Solomon Islands, PNG, Laos and Cambodia fall in the bottom two quintiles, while Samoa is ranked in the top 5 percent of countries. Asian Development Bank’s CPA adopts the same categories as the World Bank’s CPIA. Its results are also similar, with Samoa and Vietnam as the stand-out performers, and PNG, Solomon Islands and Laos ranking poorly.

² The CPIA has four components – ‘economic management’, ‘structural policies’, ‘policies for social inclusion’ and ‘public sector management’. Only low-income countries (LICs) are rated by the World Bank using the CPIA. Macro policies are measured by the economic management component of the CPIA, which covers fiscal, monetary and debt policies. Micro policies are measured by the average of the structural policy and public sector management and institutions component of the CPIA.

For example, PNG rates 3.8 for its macro policies, but only 3.1 for its micro policies; Indonesia 4.3 for macro policies, but only 3.7 for micro. Most of Australia's key partner countries have come through difficult periods of fiscal adjustment (the Philippines, Indonesia, PNG and Solomon Islands); their key challenge now is how to spend their tax revenue effectively to improve development outcomes.

While economic governance will always be difficult to measure, a positive development is that there are an increasing number of indicators to draw on. In addition to the ones already mentioned, the Doing Business indicators of the World Bank are starting to provide a means to track performance in relation to the investment climate (see Section 2.4 for further discussion), and an expanding number of countries have public expenditure and financial accountability assessments.

2 Progress against Australia's policy objectives

2.1 POLICY OBJECTIVES

Although there is no document that explicitly articulates the economic governance objectives of the aid program, Australia's aid to improve economic governance has three broad objectives:

- > improving government fiscal and financial management through the provision of technical assistance
- > supporting private-sector development, again through the provision of technical assistance
- > improving economic governance through the use of performance-based approaches.

Improving government fiscal and financial management continues to be central to Australia's support for economic governance. Technical assistance is provided for macroeconomic policy as well as budget formulation and execution.

The aid program supports private-sector development through technical assistance to governments to cut red tape and reduce business costs, promote competition, support trade and regional integration, underpin land reform and structural reform of state-owned enterprises, and support facilities designed to assist business (often small and medium enterprises).

Supporting improved governance through performance-based approaches is a new priority for Australian aid. This performance-linked approach complements the more traditional use of providing technical assistance in the economic governance sector.

2.2 EXPENDITURE BY OBJECTIVE AND COUNTRY

In 2006–07 \$169 million of Australia's overseas development assistance was directed to improving economic governance³. About 55 per cent of Australia's spending on economic governance went into fiscal and financial management (Table 2), 23 per cent went to support private sector development, and 22 per cent supported improved governance through incentive-based approaches (a significant increase on earlier years).

³ Calculations by the report's authors. These are budget and preliminary estimates, not final figures. The amount excludes unearmarked contributions to multilateral institutions.

Table 2 Australian ODA for economic governance, 2006–07, by objective

Governance subsector	Australian ODA (\$ million)	Percentage of total economic governance ODA
Fiscal and financial management	93.5	55.3
Private sector development	38.9	23.0
Incentives for improved governance	36.6	21.7
Total	169.0	

Source: Provisional estimates from the AusAID Statistics Unit compiled using Development Assistance Committee methodology.

As shown in Table 3, in 2006–07 56 per cent of Australian spending on economic governance went to the Pacific and PNG. Assistance to PNG alone constituted almost 40 per cent (\$67.5 million), although almost half was accounted for by an economic governance incentive program which was spent on roads maintenance. Considerable assistance went to Indonesia including through the Australia–Indonesia Partnership for Reconstruction and Development (5 per cent), the Philippines (12 per cent), Vietnam (7 per cent) and Solomon Islands (5 per cent). In 2006–07 significant assistance for economic governance was also provided through regional programs in the Pacific (\$7.5 million or 4 per cent) and in Asia (\$17 million or 11 per cent).

Table 3 Australian ODA for economic governance, by country

Country/region	2006–07 expenditure (\$ million)	Percentage of total economic governance ODA
Pacific and Papua New Guinea		
Papua New Guinea	67.5	39.9
Solomon Islands	9.2	5.5
Vanuatu	3.5	2.1
Samoa	0.9	0.5
Tonga	2.7	1.6
Tuvalu	1.9	1.1
Nauru	0.8	0.5
Fiji	0.3	0.2
Kiribati	0.3	0.2
Pacific regional	7.5	4.4
<i>Pacific and Papua New Guinea total</i>	<i>94.6</i>	<i>56.0</i>
Asia		
Philippines	20.0	11.8
Vietnam	13.4	7.3
Indonesia	8.7	5.1
East Timor	4.5	2.7
Laos	3.9	2.3
China	2.6	1.5
South Asia	2.5	1.5
Cambodia	1.9	1.1
Asia regional	17.0	10.1
<i>Asia total</i>	<i>74.5</i>	<i>44.1</i>
Economic governance total	169.0	100

Source: Provisional estimates from the AusAID Statistics Unit compiled using Development Assistance Committee methodology.

2.3 MAJOR INITIATIVES

This section describes major initiatives in the economic governance portfolio as of 2006–07, in relation to the three objectives outlined earlier in 2.1.

2.3.1 IMPROVING GOVERNMENT FISCAL AND FINANCIAL MANAGEMENT

At a national level Australia's major investments in improving government fiscal and financial management are in Papua New Guinea, Solomon Islands and Indonesia.

In Papua New Guinea, two major initiatives are the Advisory Support Facility (ASF) and the more recent Enhanced Cooperation Program. This program places Australian officials within central PNG agencies. The ASF places consultants within a range of agencies. While economic governance is an important focus for both the Enhanced Cooperation Program and the ASF, it is not an exclusive one.

In Solomon Islands, Australia's work in public financial management is centred in the RAMSI (Regional Assistance Mission to Solomon Islands) Financial Management and Strengthening Program, which targets macroeconomic management and budget execution, providing both in-line and advisory support.

In Indonesia the Technical Assistance Management Facility (TAMF), now in its third phase, focuses on providing technical assistance to support central government agencies. The more recent Government Partnership Fund (under the Australia–Indonesia Partnership for Reconstruction and Development) provides for agency partnerships and training for officials

Other significant public financial management projects are in the Philippines and East Timor and Vanuatu:

- > In the Philippines the Partnership for Economic Governance Reforms and the Human Resources Development Facility target public-sector capacity-building, with a strong focus on financial management.
- > In East Timor Australia's focus is on public financial management through the Ministry of Planning and Finance Capacity Building Project.
- > In Vanuatu the Governance for Growth project builds on the success of an earlier institutional strengthening project for the Ministry of Finance, but also has a broader focus on structural and regulatory reforms.

Smaller initiatives are ongoing in China, Cambodia and Tonga:

- > In China the China–Australia Governance Program provides advice and training on fiscal management and structural reform.
- > In Cambodia the Public Financial Management Reform Project focuses on budget management.
- > In Tonga the Financial and Economic Management Project supports training and provision of technical assistance in public sector management.

At the subnational level there are two initiatives of note.

- > In Indonesia, the Decentralisation Support Facility aims to coordinate donor support for decentralisation.
- > In the Philippines, the Local Government Development Program supports provincial government capacity-building in public financial management.

2.3.2 SUPPORTING PRIVATE SECTOR DEVELOPMENT AND REGIONAL ECONOMIC INTEGRATION

Most of Australia's support for private sector development and regional economic integration is delivered through multilateral organisations.

In the Pacific, the Asian Development Bank's Private Sector Development Initiative and the International Finance Corporation's (IFC) Private Enterprise Partnership–Pacific provide financial and technical assistance to support private sector development.

In Asia, Australia supports the IFC's Mekong Private Sector Development Facility in Vietnam, Cambodia and Laos, the IFC Private Enterprise Partnership for China and the Australia–Asian Development Bank Development Partnership Facility for South Asia.

Australia's support for regional economic integration is primarily through ASEAN and APEC:

- > The ASEAN–Australia Development Cooperation Program targets regional integration and partnerships between Australian and ASEAN institutions, and provides trade and economic policy support.
- > Through APEC Australia supports a number of capacity-building initiatives, including a significant investment in the APEC Public Sector Linkages Program. In addition, the Trade Analysis and Reform Project promotes integration between Vietnam, Laos, Cambodia, Thailand and the World Trade Organization.

In Solomon Islands Australia supports structural reform through the Economic Reform Unit embedded within the Ministry of Finance. The unit primarily supports reform of state-owned enterprises, the promotion of contestability in key markets, and improvements to the regulatory and investment environment for private enterprise.

Australia's support for land reform is considered to be in the category of rural development rather than economic governance.

2.3.3 INCENTIVE-BASED APPROACHES

Australia supports a number of performance-based approaches to economic governance reform, the most significant in PNG.

The performance grant payable as part of the PNG–Australia Development Cooperation Strategy promotes reform to public financial management by providing additional support when agreed performance milestones are met. In 2006–07 \$30 million was paid (to be used for road maintenance) after milestones for improved resource allocation, budget practice and performance monitoring were achieved.

The PNG Provincial Performance Improvement Initiative aims to strengthen capacity and improve service delivery at the provincial, district and local levels of government. The initiative provides technical assistance as well as performance payments to subnational governments.

In Vietnam Australia provides incentive payments to support a range of government initiatives through the Poverty Reduction Support Credit.

The Tuvalu Trust Fund aims to improve the Tuvalu government's management of its recurrent budget by providing supplementary performance-linked funding as well as technical assistance.

2.4 PERFORMANCE AND ACHIEVEMENTS

Monitoring the performance of the economic governance portfolio will always be challenging. Much of the portfolio is technical assistance, the benefits of which are difficult to quantify. It is important to keep expectations about evaluation realistic, and not assume that a more complex, detailed monitoring and evaluation (M&E) framework will replace informed and contestable judgement in evaluating portfolio performance.

Assessing progress against the three economic governance objectives (Section 2.1) is difficult because there are so many other factors at work. Nevertheless, one can certainly note that macroeconomic performance in the region has improved, and one can identify Australian technical assistance as a contributory factor in this regard (see the examples in the next paragraph). A number of countries that were facing fiscal difficulties (PNG, Solomon Islands, Indonesia and the Philippines) and where Australia has provided technical assistance in the area of fiscal policy are now in a much stronger fiscal position. It is much more difficult to judge whether the allocation and quality of expenditure has improved. Concerning the second objective of improving the environment for private sector development, in 2007 well over half East Asian countries improved their rating in relation to one or more of the World Bank doing business indicators, but only a third of Pacific island countries did. Improving economic governance through the use of performance-based approaches is a new objective and it is too early to pronounce success, but initial results are promising (see Section 3.3 for more).

At a less aggregated level, a number of individual achievements can be at least partially attributed to Australia's aid program. The latest annual review of the Regional Assistance Mission to Solomon Islands points out that tax arrears dropped from 50.7 per cent of annual tax collected in 2004 to 36.5 per cent in 2006, and debt declined from 100 per cent of gross domestic product in June 2006 to 63 per cent in June 2007. An independent review indicates that the Ministry of Planning and Finance Capacity Building Project in East Timor significantly improved budgetary

planning. An independent review of a 10-year institutional strengthening project with the Vanuatu Ministry of Finance and Economic Management quotes a government official as remarking: 'There is now a respect for the rule of law on financial management ... the project helped to teach people to respect the system'. In PNG, Australia's Enhanced Cooperation Program has helped to clear a backlog of 12 000 unassessed tax returns and to revoke 400 trust funds, which have often been used to circumvent budget and expenditure control. In Indonesia, economic management support increased taxation receipts from large taxpayers, improved bond management, and improved supervision of the government-owned banking sector. Australian aid has also helped in auctions of 3G radio spectrum bands, which will bring in around \$600 million over the next decade. Australian support has also encouraged microeconomic reforms in Indonesia.

The recently established AusAID Quality Reporting System rated 28 major economic governance activities during implementation. Table 4 summarises the results, and shows that 93 per cent of initiatives are rated satisfactory by AusAID managers in terms of achieving objectives. Scores for sustainability and implementation progress are in the 80–90 per cent range; the M&E score is lower at 71 per cent, reflecting both a general portfolio pattern of lower scores for M&E, and perhaps the difficulty of evaluating the impact of the technical assistance which constitutes the bulk of economic governance aid.

Table 4 Major economic governance initiatives assessed, 2006–07

	Achieving objectives	Implementation progress	Monitoring and evaluation	Sustainability
Percentage of initiatives rated satisfactory	93%	89%	71%	82%

Source: AusAID Quality Reporting System.

Average ratings were higher for activities in the Pacific than for activities in Asia: none of the Pacific projects was rated as unsatisfactory for either the achievement of objectives or implementation progress. One reason for this may be that expectations are lower in the Pacific.

While this review provides assurance that the economic governance portfolio is delivering, the poor performance of many partner countries on economic governance indicators suggests the need for continued examination of whether Australian aid could be more effective. Most of the causes for poor governance are beyond the influence of the aid program, and have to do with choices made or constraints faced by partner governments, which in turn have their roots in domestic politics. As discussed in the next section, however, there may be ways whereby the aid program can deliver better results.

3 Lessons

This section examines the use of technical assistance to promote economic governance, and the lessons learned about its appropriate focus and effectiveness, and about alternatives to technical assistance.

The analysis does not attempt to be comprehensive (there is no coverage, for example, of gender, training, or facilities to assist private-sector firms). The judgements made in this section draw on a number of reviews (internal and external) of AusAID's economic governance interventions, on the ongoing monitoring work of AusAID's Economics Thematic Group, and on the broader literature on economic governance aid.

3.1 THE APPROPRIATE FOCUS OF ECONOMIC GOVERNANCE ASSISTANCE

3.1.1 MACROECONOMIC OR MICROECONOMIC?

Several countries in the region have had considerable success in achieving macroeconomic stability, but much less success at promoting good microeconomic and expenditure policies (Figure 1). The AusAID 2006 report *Pacific 2020* noted that economic reforms so far have not had the pay-off expected, one reason being that 'reforms so far have focused more on stabilisation than on growth-promoting structural reforms' (p. 40).

The reason for this is in large part the choices and constraints facing partner governments. Microeconomic reforms are often more threatening to particular groups (vested interests) than macroeconomic reforms. Support for microeconomic reforms will need to be opportunistic, to provide support for reforms that are politically feasible. And macroeconomic stabilisation will have to remain a priority in countries which are facing a macroeconomic crisis or risks of one. Nevertheless, the aid program also seems to have had too much of a macroeconomic focus and a tendency to focus on upstream budget issues rather than downstream expenditure or microeconomic reform. This was one of the criticisms of the (generally successful) Vanuatu Ministry of Finance project.

There are already attempts to do more to support microeconomic reforms.

- > Governance for Growth, the new economic governance facility in Vanuatu, has an explicit focus on reforms that will promote growth, and is currently supporting telecom liberalisation.

- > Part of the economic governance assistance provided by RAMSI is for the establishment of and support to the Economics Reform Unit in the Solomon Islands Ministry of Finance which provides advice and implementation support on microeconomic reforms.
- > The highly successful Technical Assistance Management Facility in Indonesia has always had a strong focus on microeconomic reforms, including in the financial sector.

3.1.2 PLANNING OR IMPLEMENTATION?

A common criticism of the technical assistance provided to date is that it has overemphasised planning and had an inadequate focus on implementation. Advisers have helped governments to produce corporate plans, budgets and reform designs, but have sometimes provided little help on budget or reform implementation.

This was a criticism of the East Timor Ministry of Planning and Finance capacity building project which is credited with helping East Timor develop excellent budget preparation processes, but did little or nothing to improve budget execution. In 2005–06 East Timor spent only US\$1 million out of a US\$29 million capital budget.

With the commodity boom boosting government revenue, at least four of Australia's major partner countries – PNG, Indonesia, Solomon Islands and East Timor – are struggling to expend their budgets.

This is a difficult problem to solve. Budgets are formulated by a few people in a central agency, but implemented by many people spread across government agencies. Budget preparation is thus much more susceptible to the influence of a small number of external technocrats (they can do it directly, train a few people to do it, or both) than is budget implementation (where entire systems have to be changed and many people trained).⁴

There is no doubt that a reorientation of provision of technical assistance towards budget implementation and reform implementation is justified, and is starting to occur. In the new phase of Australia's economic governance assistance to East Timor, there is a larger focus on budget implementation, for example through procurement implementation assistance and reform. Similar shifts in emphasis are needed in other partner countries where governments are having difficulty implementing their budgets not because of resource constraints but because of limitations of capacity. Australia will need to promote innovative solutions, including the use of private sector and non-government delivery mechanisms.

To improve implementation, a dual approach is needed. Financial controls need to be strengthened to reduce corruption and waste, and implementation capacity needs to

⁴ Lant Pritchett and Michael Woolcock (2003), 'Solutions when the Solution is the Problem: arraying the disarray in development', www.econ.nyu.edu/cvstarr/conferences/ForeignAid/papers/Woolcock.pdf

be strengthened to enable spending of budgets. Emphasis to date has largely been on the former, and significant progress has been made. For example, the Financial Management Strengthening Program in Solomon Islands, the enhanced cooperation program in PNG, and TAMF in Indonesia have all had successful anti-corruption impacts. However, more emphasis is needed on strengthening implementation capacity, on how to spend more, and on how to spend more effectively.

3.1.3 'GOOD ENOUGH' GOVERNANCE

The international development literature stresses the principles of 'good enough' governance, and the risk of donor projects resulting in the development of overambitious and complicated systems of governance.⁵ The review of the case studies suggests that this is not a big problem for the Australian aid program because most of the focus is on improving existing basic systems of governance. Yet it remains a risk. For example, the Vanuatu Ministry of Finance project wasted considerable resources introducing accrual accounting, with no apparent benefits.

3.2 THE EFFECTIVENESS OF ECONOMIC GOVERNANCE TECHNICAL ASSISTANCE

3.2.1 COUNTRY OWNERSHIP AND MANAGEMENT

The importance of ownership of technical assistance for its effectiveness is widely recognised. A recent study concludes that:

A key determinant of TA effectiveness is country management of TA personnel. Decisions about recruitment and deployment should ideally be a country responsibility, negotiated openly with development partners and based on full access to information (including the costs of alternative TA inputs). Once deployed, TA personnel should be unambiguously accountable to the host organisations they serve.⁶

In general, Australian economic governance programs have several features which promote country ownership: involving partner governments in design, review and selection processes. In some cases, as discussed below, it might be possible to go further and provide governments with the funding which they will use to engage consultants.

3.2.2 TECHNICAL ASSISTANCE IN NON-REFORM ENVIRONMENTS

Some argue that aid to poorly run governments should be solely in the form of technical assistance since project (investment) funds will be wasted. Others argue that technical assistance in a non-reforming context is itself a poor investment, as it has no purchase on decision making.

⁵ Merilee Grindle (2002), 'Good enough governance: poverty reduction and reform in developing countries', www.gsdr.org/docs/open/HD32.pdf

⁶ Anthony Land (2007), 'Joint Evaluation Study of Provision of Technical Assistance Personnel: what can we learn from promising experiences?', Discussion Paper 78, ECDPM.

The experience of the AusAID portfolio of economic governance assistance is that provision of technical assistance can help, even in environments that are not particularly pro-reform. In most of the countries where the Australian aid program is active, there are both pro-reform and anti-reform elements in government. Technical assistance can strengthen the hands of reform champions and help them achieve more than would otherwise be possible. Technical assistance can also help put barriers in the way of poor policy decisions, and so prevent things getting worse.

Yet it is easy to overestimate the influence of technical assistance. As Paul Collier has written in his recent book *The bottom billion*: ‘Change in these societies at the very bottom must come predominantly from within; we cannot impose it on them’ (2007, p. xi). It is therefore important to be realistic about what technical assistance can achieve and not to overestimate its potential impact. The first objective for the Solomon Islands Financial Management Strengthening Program is to ‘foster political will’ for reforms. As important as this goal is, it is an unrealistic one for a technical assistance program.

3.2.3 PUBLIC OR PRIVATE?

Economic governance assistance is increasingly being delivered by Australian public servants (deployees) rather than contracted consultants. This is a trend across the aid program, but is particularly evident in the governance sector. For economic governance, deployees are mainly from the Australian Treasury and Department of Finance, and for law and justice programs, from the Australian Federal Police. Economic governance programs in the partner countries of PNG, Solomon Islands, Indonesia and Nauru all make use of government deployees.

This use of donor-country civil servants is an innovation in the international development context, and has attracted interest from several other countries. There are, however, limits to this strategy: Australian central agencies face their own capacity constraints and not all partner governments are comfortable with the use of deployees. As a result, major economic governance programs typically have a mix of publicly and privately delivered programs. For example, in PNG assistance in economic governance is provided both by Australian central agency deployees (through the Enhanced Cooperation Program and departmental twinning programs) and by private consultants (through the PNG Advisory Support Facility). Similarly, in Indonesia, TAMF supplies consultants to work in economic governance areas, whereas the new Government Partnerships Facility supplies Australian government officials.

It is difficult to judge the relative efficacy of these different modes of aid delivery.⁷ The relative advantages of using deployees appear to come from the long-term

⁷ Table 2 of the 2007 Anthony Land paper (see footnote 6) provides an extended list of the advantages and disadvantages of using deployees to fill TA positions.

institutional linkages, including information flow and departmental support, they can build between Australian and partner government institutions. These integrating links are particularly important for the smaller countries of the Pacific region. Deployees also have up-to-date information on Australian government systems, and gain an interest in development that often outlasts their period of deployment.

There are no systematic data on length of stay, but deployees tend to be abroad for two or three years. Length of stay for private consultants is much more variable. Experiences in Vanuatu, East Timor and Indonesia suggest that the majority of the most effective consultants all had considerably longer overseas stays. As discussed in Section 3.2.6, private consultants tend to be cheaper than deployees, at least based on PNG experience. Now that aid is untied, private consultants are more likely to come from different countries, and so bring with them a range of good practices and experiences.

Overall, at the aggregate level, it does not appear to make a decisive difference whether deployees or consultants are used to implement economic governance interventions. Good examples can be found of using both modes and use of both is likely to be the case in coming years. This will require greater emphasis on coordination and harmonisation of efforts within the Australian aid program, and greater attention to consideration of areas of comparative advantage.

3.2.4 DOING AND BUILDING

Most technical assistance provided on economic governance should be assessed against the twin objectives of building capacity in the area of economic governance (*building*) and directly undertaking economic governance tasks (*doing*). Both are important.

Much of AusAID's work has stressed the importance of capacity building through the provision of advisers. For example, the website for the Advisory Support Facility (ASF) in PNG – a large crosscutting facility that provides a significant amount of economic governance support – states that:

ASFII [i.e. ASF Phase II] advisers operate in an advisory and educative capacity rather than as a consultant or in-line replacement for a PNG public servant. Their primary focus is to enhance skills and build capacity within their host agency, rather than to simply conduct reviews, write reports or 'do the job'.⁸

The question of whether personnel providing technical assistance should *do* or *build* is a complex one, and much has been written on the most effective modes of capacity building.⁹ Most personnel occupy a grey area where they do some of both.

⁸ <http://pngasf.com>. Note that the reality is more complex than this web statement suggests; many ASF advisers take on an in-line role, at least in part.

⁹ See the reference in footnote 6 for a recent overview.

To quote from a recent review of technical assistance for economic governance in the Pacific by Professor Ron Duncan for the 2007 Forum Economic Ministers Meeting:

The most persistent message running through the feedback from the country visits and correspondence was that country officials, mainly at a high level, were overburdened with visits by staff of international and bilateral agencies and their consultants on TA assignments ... The frequency of such visits is placing severe stress on the countries' limited capacities and hindering their ability to undertake other work.¹⁰

The Duncan review implies that technical assistance for economic governance is over-allocated to advisory functions in the Pacific. Greater cooperation among donors would help prevent duplication. But more fundamentally, the Duncan review suggests that Pacific governments need more help with *doing* to be able to absorb the considerable amount of advisory assistance available to them. It needs to be recognised that small and very poor states will need to import skilled staff for a long time, perhaps indefinitely.

At the same time, engagements which do have a strong *doing* focus – such as the Enhanced Cooperation Program in PNG and the Financial Management Strengthening Program in Solomon Islands – equally need to be more conscious of the capacity-building imperative, as recommended for example by a 2006 review of the Financial Management Strengthening Program.

The Vanuatu Ministry of Finance and Economic Management Institutional Strengthening Project was particularly successful at both *doing* and *building*. It had significant elements of in-line support (often delivered by personnel formally designated as 'advisers'), but also helped build capacity through on-the-job training and assistance with the recruitment of new staff. The long duration of the project (seven years) helped in the achievement of both objectives, as did the long in-country residency of some of the key consultants.

The situation in larger countries is often very different, and the use of advisors often the only required or appropriate option. Experience with TAMF in Indonesia suggests that long-term advisers integrated into departmental structures can be very effective, in part by helping other advisers who are shorter-term and assigned more specific tasks.

3.2.5 NON-TRADITIONAL FORMS OF TECHNICAL ASSISTANCE

Models of technical assistance for economic governance other than traditional consultants or deployees deserve consideration. In PNG, a small amount of support goes to Overseas Development Institute (ODI) Fellows, graduates in economics without work experience, who are relatively inexpensive (about \$55 000 per year).

¹⁰ Ron Duncan (2007), 'Pre-Feasibility Study for the Establishment of an Accountable and Independent Macro-economic and Micro-economic Technical Assistance Mechanism', Report to the Pacific Forum Secretariat.

Since a number of ODI fellows stay in the region, support for the program is also an investment in the region.

Another model worthy of consideration is the provision of funding to partner governments to hire expatriates, as was used in the past in PNG, and in Botswana:

TA personnel are generally assigned to established posts (line positions) rather than to projects or advisory positions; and TA personnel are contracted by, and are responsible to the government in the first instance, and to the sponsoring donor second.¹¹

The model has several advantages. It is cheap (expatriates hired directly by the PNG Government today might cost very roughly about \$150 000). Partner governments have ownership: they are forced to set priorities and make choices, and expatriates report to the government, not to a donor. It leads to the hiring of staff to fill important in-line vacancies, or advisory positions, as advisory governments see fit. The disadvantage of this model is that government procurement systems can often be cumbersome. While donors can provide procurement assistance, some governments prefer donors to procure consultants on behalf of the government, in which case budgetary funding will not be appropriate.

Another alternative to providing governments with external expertise is to use aid funds to hire local staff. This option can be very successful and can result in considerable financial savings. For example, one of the most successful initiatives in Solomon Islands has been support for the Office of the Auditor-General, in which the aid program has been used to pay graduates of the Solomon Islands College of Higher Education for their first year in the Office of the Auditor-General.

Aid program funding for local staff raises questions about sustainability, but long-term funding for these positions could be provided, based on the long-term commitments Australia has to many of its partner governments. This is not a solution where local skills are unavailable, but can be a cost-effective way to build local capacity. In many countries, hiring is a fraught and difficult process, so one benefit of this approach is the technical support and incentive it provides to the recipient agency to recruit staff.

Finally, an intermediate position between funding local staff and hiring expatriate consultants or using deployees is to fund local consultants. The Vanuatu Ministry of Finance and Economic Management institutional strengthening project recently used mostly local consultants to write the national *Drivers of change* report, and is planning to switch funding from expatriate to national consultants to support the financial IT system established under the project.

¹¹ Anthony Land (2002), 'Taking Charge of Technical Cooperation Experience from Botswana: a case of a country in the driver's seat', Discussion Paper 24, EPDCM.

3.2.6 COST EFFECTIVENESS

There are significant cost differences between the different forms of technical assistance discussed in the preceding sections. For example, in PNG, rough estimates of annual costs are around:

- > \$400 000 for a mid-level government deployee (under the Enhanced Cooperation Program)
- > \$340 000 for a mid-level consultant (under the Advisory Support Facility)
- > \$150 000 for an expatriate consultant hired directly by the PNG government
- > \$55 000 for an ODI Fellow
- > \$6000 for a national graduate.

(Note that these are 'all-in' costs, including salaries, overheads, and related expenses. The last three estimates are very rough estimates, intended to convey only orders of magnitude.)

These alternatives are by no means perfect substitutes, and sometimes not substitutes at all. Their benefits are quite different, but a full consideration of costs as well as benefits is warranted.

3.3 ALTERNATIVE APPROACHES: THE USE OF PERFORMANCE-BASED PARTNERSHIPS

So far this report has focused on the use of technical assistance to improve economic governance. Increasingly, the program is using incentive- or performance-based approaches to promote good economic governance.

The performance-based approaches currently underway in PNG, Vietnam and Tuvalu all seem to be working, although some have been underway for only a short time. Other performance-based approaches are being prepared and implemented as part of the 2007–08 Australian budget announcement of \$116 million over two years for a performance incentives initiative that will support the implementation of important economic and governance reforms in selected countries, including Indonesia, the Philippines, Vanuatu and Tonga.

The strength of the performance-based approach is its recognition that poor economic performance often has nothing to do with weak technical capacity. If capacity is not the binding constraint on growth, strengthening it may have no effect: good advice may be given but not heeded; good policies may be developed but not implemented. Put differently, if the right incentives are in place, the productivity of technical assistance can be greatly enhanced.

The Australian aid program makes much less use of performance-based approaches than do many other aid programs. While this new approach will need to be carefully monitored, initial (and admittedly recent) experience gives grounds for optimism.

Acronyms and abbreviations

APEC	Asia–Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ASF	Advisory Support Facility (PNG)
CPIA	Country Policy and Institutional Assessment (World Bank)
IFC	International Finance Corporation
ODA	Official development assistance
ODI	Overseas Development Institute
PNG	Papua New Guinea
RAMSI	Regional Assistance Mission Solomon Islands
TA	technical assistance
TAMF	Technical Assistance Management Facility in Indonesia
WGIs	Worldwide Governance Indicators