NATIONAL GOVERNMENT CONTROL OF FUNDING OF PROVINCIAL ACTIVITIES

Anthony J. Regan

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INTRODUCTION

The introduction of the provincial government system in Papua New Guinea in 1977 involved an attempt to make a radical redistribution of the powers and resources of the state. The Organic Law on Provincial Government (the Organic Law) was the legislative tool used to effect this redistribution. Crucial to the success of the redistribution was the question of control of financial resources. The Organic Law was intended both to provide a large share of national revenue to the provinces and to give them a high degree of independence in the way they allocated that revenue.

This paper examines the development and operation of several mechanisms which have resulted in increased central control over funding for provincial activities, often in ways that are contrary to or at least outside the terms and the spirit of the Organic Law. The paper illustrates the difficulties involved in using legislative change to redistribute power and resources, especially if powerful groups and institutions are not committed to or oppose redistribution. For although the main focus of the paper is the bundle of financial control measures which have reduced the degree of decentralisation envisaged by the Organic Law, the paper also shows that the development and operation of the control measures has been part of a more general movement of power back to the national government. An understanding of the extent of control exercised is important in the context of ongoing debate on the provincial government system—a debate which sees some protagonists arguing the need for increased national control often in ignorance of the extent of the control measures already available.

The main control measures examined are:

- the arrangements for full financial responsibility which have operated since 1978; and
- certain additional funding arrangements which, since 1983, have operated under Divisions 271 to 290 of the annual national estimates of revenue and expenditure.

The Organic Law envisages that the national government should fund provincial governments in such a way that provinces largely determine their own priorities and that such funds should be accounted for by the provinces as their own. But the financial arrangements examined in this paper have brought a significant proportion of the funds allocated to provincial activities under a high degree of national government control. That control is largely achieved by the national government allocating such funds to national government created public service departments in each province, rather than as grants to the provincial governments themselves. Funds appropriated under Divisions 271 to 290 of the annual national estimates of revenue and expenditure are allocated to provincial activities and accounted for by provincial staff, but those funds also have to be accounted for as national department funds and so must be kept completely separate from funds allocated under the provincial governments' own budgets.
The paper argues that the arrangements are contrary to the Organic Law. But quite apart from questions of legality, the arrangements give rise to a necessity that all provincial governments maintain two completely separate sets of accounts -- an expensive, inconvenient and wasteful exercise which adds to existing provincial management and planning problems. The significance of these arrangements can be seen in the high proportion of funding of provincial activities which is dealt with under the arrangements. The funds in question are those which the provincial governments are required to account for through their Bureau of Management Services offices under Divisions 271 to 290. In 1986 the amount in question was K43.8 million, or 31 percent of the total funding of provincial activities accounted for by provincial BMS offices (see Table 4).¹

The paper is in six parts. Part One looks at aspects of the attempted redistribution of power embodied in the Organic Law, and in particular the financial provisions of that Law. Parts Two and Three examine the details of the erosion of financial independence that has occurred since 1978. Part Two describes the operation of the financial arrangements in the period from 1978 to 1982, in particular the arrangements for full financial responsibility. Part Three examines the financial arrangements in the four-year period 1983 to 1987, during which national control was extended over a wider range of funding of provincial activities in all provinces (including those that have achieved full financial responsibility). It will be evident from the discussion in Parts Two and Three that the financial arrangements analysed in those parts represent a significant diminution of the degree of financial independence for provincial governments envisaged by the Organic Law and that the growth of national control has had wide-ranging effects. The outcomes include: increased power of provincial bureaucrats at the expense of provincial politicians; increased national control of provincial bureaucracies; and widespread planning and administrative problems for provincial governments. As a result there are good practical reasons for changing the arrangements. But Part Four argues that, in addition, the arrangements are contrary to the Organic Law, and hence illegal.

It will be evident, then, that a number of aspects of the existing financial arrangements require change. Realistic changes to those arrangements can only be framed with reference to the broader context of national-provincial relations. In Part Five,

¹ Divisions 271 to 290 funds accounted for by provincial staff do not include the large proportion of funding for provincial activities used to pay the salaries of members of the Public Service and the Teaching Service who carry out those activities (see Tables 3 and 7). Funds to pay those salaries are allocated through Divisions 271 to 290, but are retained by the national government, which remains responsible for payment of staff assigned to the provinces.
there is an attempt to analyse the likely future direction of national-provincial relations. On the basis of this analysis, proposals for change to the financial arrangements are put forward in Part Six.

The major recommendation made is that the financial arrangements under Divisions 271 to 290 should be done away with. In future, all funding for provincial activities should be channelled through provincial budgets as either unconditional grants or conditional grants. This would greatly reduce complexity, confusion and other problems caused by the present arrangements. However, the recommendation would allow the national government to keep a high degree of control where necessary — for example, in provinces without full financial responsibility — by creative use of conditions attached to conditional grants.

At the time of writing (early 1987) comprehensive amendments to the financial provisions of the Organic Law are being prepared by the national government. They are largely based on recommendations of a 1984 report — commonly referred to as the 'Specialist Committee Report' — entitled 'Review of Intergovernmental Fiscal Relations in Papua New Guinea' (Department of Provincial Affairs 1984). Neither that report nor any other recent writings on provincial government finances have analysed the arrangements dealt with in this paper — arrangements fundamental to an understanding of the funding of provincial governments but also complex and little known. Accordingly, as well as being a study of ways in which national government control has been reasserted over provincial governments, the paper is written in part as an attempt to explain the development and operation of the financial arrangements and in part as a contribution to discussion of proposals for amendment to the financial provisions of the Organic Law.
PART ONE: FINANCIAL ARRANGEMENTS IN THE ORGANIC LAW ON PROVINCIAL GOVERNMENT

As the paper argues that significant aspects of the present financial arrangements for provincial government are contrary to the Organic Law it is necessary to first outline the main features of the financial arrangements originally envisaged by that law.

Division of Powers and Resources

The financial arrangements for provincial government must be seen within the general scheme for government arrangements provided by the Organic Law. That law, passed 18 months after Papua New Guinea achieved independence, established provincial governments as bodies with some degree of equality with the national government. Several points need to be made about the balancing of national and provincial interests in the Organic Law: provincial governments are intended to have a significant share of powers and functions, and sufficient resources to utilise those powers and carry out the functions; formal mechanisms for dealing with intergovernmental relations indicate some degree of equality between the levels of government; ultimate authority is retained at the national level through various control mechanisms, including power to graduate the powers and responsibilities of the provinces.

These points require brief explanation. First, provincial governments are intended to share in the powers and resources originally vested by the independence Constitution in the national government. Under the Organic Law, the two levels of government share legislative activities, provincial governments carry out many functions formerly performed by the national government, and personnel resources (the public service) are shared, as are financial resources available to government. Provincial governments are intended to have a considerable degree of independence in the use of their share of powers and resources. However, the national government must be kept advised about some aspects of the exercise of provincial powers and functions through such devices as notice of passing of provincial laws and annual reports on the financial affairs of the province (ss.35, 36 and 73).

Second, the Organic Law anticipates the possibility that the extensive powers and resources of provincial governments may result in conflicts developing between the levels of government or between provinces. To minimise conflict, the Organic Law provides for consultation about potentially contentious matters (ss.30, 37, 46, 49, 50, 52, 76 and 85). If disputes do develop, the governments are

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2 Organic Laws are a form of Constitutional Law which normally cover matters specifically authorised by the Constitution. They are generally as difficult or almost as difficult to change as the Constitution itself (ss.12, 14 and 17 of the Constitution).
discouraged from dealing with them through the courts. Some
matters are 'non-justiciable' -- they cannot ordinarily be dealt with
by a court (ss.29, 44 and 61). There are alternative dispute
settlement mechanisms such as the National Fiscal Commission
(ss.75-81, and s.62) and the Premiers' Council (ss.82-84). These
and other aspects of the arrangements under the Organic Law indicate
a degree of equality between the levels of government -- the
national government is not always free to impose its will.

Third, the independence of the provincial governments is
balanced by the national government retaining ultimate control in a
number of ways -- it can disallow the exercise of provinces' legislative powers (s.37), control access to personnel resources
(s.49) and suspend mismanaged or corrupt provincial governments
(Part XII). But the exercise of most coercive powers is limited by
important procedural safeguards. For example, a lengthy and complex
set of procedures must be followed before the National Parliament
can disallow a provincial law. The aim always is to ensure that
coercive powers will only be used when necessary.

By use of complex procedures under ss.100 and 101 of the
Organic Law, it is possible for the National Parliament to hold back
from particular provincial governments any of the 'powers, functions, duties or responsibilities' that the Organic Law
otherwise provides to them. However, ss.100 and 101 have never been utilised, and so, in theory, all provincial governments should have
the same powers and functions, financial and otherwise.

Funding Arrangements

The Organic Law's provisions on financial arrangements are
consistent with the general scheme just described. Whilst provinces
are intended to be largely dependent on transfers of funds from the
national government, most of the transfers are to be unconditional, leaving provinces free to allocate most of their revenues according
to provincial priorities. Dependence on grants should not be seen
as an indicator of a high degree of national control -- the key
grants are calculated according to formulae laid down in the Organic
Law and are allocated unconditionally. The arrangements are
designed to ensure a degree of certainty that provinces will obtain
sufficient resources to carry out their functions.

The complex financial provisions of the Organic Law do not
require detailed description here. Rather, the point needs to be
made that the central fiscal provisions of the Organic Law provide
for a high degree of independence for provincial governments. This
is the case with provisions on:

3 For detailed descriptions of the financial arrangements see
- sources of provincial revenue;
- authorisation and control of spending of revenue; and
- provisions concerning accounting, records and accountability.

(For ease of reference, the sections of the Organic Law referred to in the following discussion are set out in full, in numerical order, in Appendix 1.1.).

The main sources of provincial revenue (summarised in s.53 of the Organic Law) are specific kinds of transfers from the national government. The most important transfer is the Minimum Unconditional Grant (MUG). Although intended to be unconditional, its formulation involves some inherent contradictions, not least of which is the fact that despite being called 'unconditional' it tends to be tied to maintaining government activities transferred to the provinces by the national government -- this is because it is calculated according to a formula designed to maintain levels of activities transferred from the national government (s.64 and Schedule 1.).

Despite such problems, the MUG aims to meet important purposes, including: ensuring that the amount of the main source of provincial funds is determined independently of the national government and thus free from the influences of political vagaries at the national level; and giving each province a large source of revenue able to be allocated according to local perceptions of local needs and priorities. Hence the MUG can be said to aim to provide some degree of fiscal independence to the provinces. There are less important unconditional grants which also contribute to fiscal independence. They are:

- a small staffing grant (s.51);
- additional unconditional grants above the minimum (s.79);
- a derivation grant (s.66); and
- transfers of the proceeds of certain national taxes (s.67).

Each of these grants must be paid each year, except for additional unconditional grants, the payment of which are at the discretion of the national government. In addition, s.65 permits the national government to allocate conditional grants for purposes and upon conditions agreed between the national government and the provincial government concerned.

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4 Some of the inherent problems in the MUG formula tend to make it inadequate for its intended purpose. Further, there are indirect (and possibly illegal) controls which the national government can apply to the use of the MUG which to some extent can reduce the unconditional nature of the grant (Department of Provincial Affairs 1984, Vol.2: 49-53; Regan 1986a).
Even though the various sections of the Organic Law just cited are of themselves enough to make all unconditional grants (with the exception of additional unconditional grants) lawfully payable by the national government annually, s.68 provides that the minimum unconditional grant, the derivation grant and the transfers of national taxes are payable without any annual appropriation under the national budget. Section 68 is indicative of the emphasis of the Organic Law upon the fiscal independence of the provinces, because it seeks to ensure that the provincial governments' main sources of funds are not dependent on annual parliamentary decisions concerning appropriation legislation. 5

The Organic Law also makes available to provincial governments a limited range of sources of internally raised revenue, intended to reduce the otherwise total reliance on external funding sources (CPC 1974, Vol.1:10/118). Although the narrow economic bases of most provinces mean that in a majority of provinces internal revenue sources are relatively unimportant, they do provide significant revenue in a few cases (see Appendix 4, Tables 3 and 7).

Authorisation and control of spending of provincial revenues is not dealt with in any detail in the Organic Law, which largely leaves internal structural matters to the decision of each provincial government. As a result, provision on this subject is made in the constitution of each province (Regan 1986b). As foreshadowed by s.42b of the Organic Law, all provincial constitutions include provisions similar to ss.209 to 211 of the national Constitution: provincial legislatures have power to authorise and control all revenue and expenditure for each fiscal year; provincial executives must initiate fiscal measures; and expenditure of provincial funds must be in accordance with provincial laws. (For purposes of comparison, the provisions of ss.209 to 211 of the national Constitution are set out in Appendix 1, as is the text of relevant provisions of a typical provincial Constitution, namely ss.42-44 of the Constitution of East New Britain -- see Appendices 1.2 and 1.3).

In establishing financial arrangements under these provisions, each province passes an annual appropriation act (together with an annual budget) and each has passed a financial administration act regulating the way provincial funds can be dealt with. As provided by s.6 of the Organic Law, the national government has accepted the financial provisions in each provincial constitution, and in doing so has clearly accepted the principle that there should be independent financial systems in each province. The criteria established by the national government for granting of full financial responsibility provide incentives for provinces to establish their financial systems promptly.

5 Goldring (1978:103-104) has argued that s.68 may offend s.209(2) of the national Constitution which requires annual estimates of revenue and expenditure.
Accounting, records and accountability are dealt with both in the Organic Law and in provincial constitutions. The Organic Law requires that a province shall keep proper accounts and records of its transactions and affairs and shall ensure that 'all payments out of its moneys are correctly made and properly authorised' (s.72). This section provides authority for provisions of provincial constitutions dealing with control of expenditure, and for provisions of provincial governments' financial administration acts concerning control of and accounting for expenditure. Although the financial systems of provincial governments are clearly intended to be quite separate from that of the national government, provinces are ultimately accountable to the national government. Each province must make 'a full statement of the financial position and of the affairs of the province' to the national government annually (s.73) and the national government's Auditor-General must make an annual inspection and report on the 'accounts, moneys and property' of each provincial government (s.74). But the very fact that reports are to be made and audits carried out in this way provides additional evidence that the provinces' financial systems are intended to operate independently of the national government's budgetary, financial and accounting arrangements. Otherwise, separate financial statements would not be required, and audit reports on provincial finances would be subsumed under the Auditor-General's reports on the national government's finances.

Transfer of Activities

The last of the Organic Laws' financial provisions to be discussed are those dealing with funding of activities responsibility for which has been transferred to the provincial governments (henceforth referred to as 'transferred activities'). These provisions must be understood because the validity of many of the financial arrangements discussed in the rest of this paper depends in part upon whether or not the major activities carried out by provincial governments have been 'transferred' — within the meaning of the Organic Law — to the provinces by the national government. If they have been so transferred, the arrangements for full financial responsibility and Divisions 271 to 290 of the national budget are arguably without legal foundation.

The Organic Law envisages that the national government will transfer to provincial governments the responsibility for carrying out some activities previously carried out by the national government. The Organic Law links the transfer of funds and staff with the transfer of activities, but does not make specific provision for legal mechanisms to effect the transfers, nor for the legal basis upon which provinces are to carry out the activities once they are transferred. Presumably these matters are not specified in order to allow the arrangements to remain flexible. The Organic Law (s.64 and Schedule 1.) is clear that when activities are transferred, funding for the activities must be provided by the national government by way of the MUG. In fact, the MUG is
calculated by reference to the costs to the national government of carrying out each of the transferred activities prior to their transfer, using the costs to the national government of carrying out the activities in the 1976-77 fiscal year as a base figure (Schedule 1.). Provisions concerning transfers of staff are less clear but the general intention seems to be that the provinces should be assigned control of at least those members of the national public service who carried out the transferred activities prior to their transfer to the provinces. This follows from Schedule 1.3. and s.49: Schedule 1.3. enables the national government to deduct from the MUG, prior to its payment, the estimated costs of salaries and allowances of 'assigned' public servants carrying out the transferred activities in the year of grant; and s.49 makes general provision for the Public Services Commission to 'assign' public servants to provincial governments.

As the amount of the MUG is based upon the costs of carrying out transferred activities, much depends upon the definition of a 'transferred activity'. That expression is defined only in Schedule 1.1. of the Organic Law which provides that a 'transferred activity' is one that was carried out by the national government in the 1976-77 fiscal year and is carried out by the provincial government in question 'at some time after the fiscal year 1976-1977 or is to be carried out in the year of grant'. The Organic Law does not give guidance on determining whether or not an activity is at any particular time being 'carried out' by a provincial government. However, as the national public service is a resource shared between national and provincial governments, determining which government controls staff carrying out activities would seem a commonsense way of determining which government is carrying out the activity. As is discussed in more detail in Part Four of this paper, in a legal opinion published in a report of the Auditor-General in 1981, the Department of Justice advanced a view along these lines (Auditor-General 1981:3-19). The approach is given weight by the fact the Organic Law requires salaries and allowances of public servants 'assigned to the provincial government for the carrying out, in the year of grant, of transferred activities' to be deducted from the MUG prior to payment (Schedule 1.3.), evidence that control of public servants and the carrying out of activities are intended to be linked.

If control of assigned public servants is a valid test for determining whether or not a provincial government is carrying out an activity, then it may be argued that activities presently being carried out by provincial governments but being funded under Divisions 271 to 290 of the national budget should instead be funded under the MUG. This would move a significant part of the present funding for provincial activities away from the control of the national government. This is one of the issues examined in the next parts of this paper.

This part of the paper concentrates on the development and operation, in the 1978 to 1982 period, of a particular aspect of the financial arrangements — the arrangements for 'full financial responsibility'. As will be seen in Part Three, the full financial responsibility arrangements have continued to operate in a slightly different form in the 1983 to 1987 period.

A Mechanism for Transfer of Activities

In late 1977, during the period when the provincial government system was being established, there was a need for a flexible mechanism for transferring activities on a uniform basis to provincial governments as they became established. The activities to be transferred had already been identified by a National Executive Council decision in January 1977 (National Executive Council Decision No.19 of 1977). A transfer mechanism was required because national public service departments had difficulty, first in disaggregating from their existing structures and then in transferring individual activities (together with funds and staff used to carry out the activities) to each of the 19 new provincial governments. The process was made particularly difficult because the provincial governments were not all established at the same time, but instead, over a period of more than two years.

The transfer mechanism suggested by management consultants McKinsey and Co. and adopted by the National Executive Council (NEC) in September 1977 was to notionally transfer activities, staff and funds from the 'parent departments' (Education, Primary Industry, etc.) to the Office of Implementation in the Department of Decentralisation. (NEC Decision No. N.G.10 of 1977). As each provincial government became fully established, the activities, staff and funds would be transferred on to them from the Office of Implementation. Despite misgivings expressed by many national government officials, the NEC accepted the McKinsey and Co. recommendation that the activities be transferred to provinces on a uniform basis. By using the Office of Implementation as a transfer mechanism, there was to be administrative decentralisation 'across the board rather than function by function and department by department' and 'political decentralisation' was to follow as provincial governments became fully established (McKinsey and Co. 1977:8).

The activities identified for transfer were the provincial works programme (including capital works, maintenance and the Rural Improvement Programme - R.I.P.), and a number of specific activities then being carried out by existing public service departments namely, Provincial Affairs, Health, Primary Industry, and Education, and also the business development functions of the Department of Commerce and the information functions of the Department of the
Prime Minister. Later (during 1978) a seventh functional area was added - Bureau of Management Services, which was responsible for financial and other management functions. These activities and the staff in the 19 provinces who were carrying them out were notionally transferred to the Office of Implementation. As from 1978, a special division of expenditure (Division 248) was created in the annual budget estimates for the Office of Implementation and in that year, in all provinces except one, the funding for the transferred activities was allocated through Division 248. The exception was North Solomons, which alone received MUG funding for the transferred activities, the reason being that it had become fully established in 1977, and so the activities were officially transferred to it from the Office of Implementation in October 1977.

Full Financial Responsibility (FFR)

By mid-1978, a number of the transferred activities had been transferred from the public service departments to the Office of Implementation, but had not been transferred on from that Office to any province other than North Solomons. Despite the NEC's direction that transfers be made from the Office of Implementation as provincial governments became fully established, officials in the Department of Finance believed that most provincial governments had neither the trained personnel nor the procedures established to adequately control the unconditional grant funds which should have accompanied the transfer of activities. The department was concerned that if transfers of activities were to be made as soon as each provincial government was fully established, financial and budgetary chaos would result. For this reason the department proposed and the 1978 Premiers' Council Conference agreed that transfers would not be made from the Office of Implementation until

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6 The technical device used to vest responsibility for these activities in the Office of Implementation (Department of Decentralisation) was a determination of the functions of that department formally made and gazetted on 29 December 1977 under which the Department's functions were to include the following:

'3. to the extent that the responsibility for carrying out such activities has not been assumed by provincial governments, and until it is so assumed-

(a) exercise in the provinces such powers and functions as are made (sic) from time to time specified by decision of National Executive Council as provincial powers and functions and are transferred to it from other Departments---'
a provincial government demonstrated it had met a number of criteria which were to be regarded as evidence of development of sufficient financial management capacity to manage the transferred activities. When this happened, a province was ready for 'full financial responsibility' (FFR) and funds, staff and responsibility for the conduct of transferred activities would be transferred to it from the Office of Implementation.

The criteria for granting FFR accepted by the 1978 Premiers' Council conference (set out in Appendix 2) encouraged provinces to improve their financial management by establishing and operating effective finance and budgeting systems separate from those of the national government. The criteria included: passing of a provincial financial administration law; achieving satisfactory budgeting capacity; and establishment of an accounting system for the province compatible with its finance legislation, regulations and budget format. FFR arrangements were intended to provide the Department of Finance with a mechanism for differentiating between the financial management capacities of the provinces, and for retaining a high degree of financial control in provinces judged as having insufficient capacity.

The FFR arrangements were designed around, but also made modifications to, McKinsey and Co.'s mechanism for transfer of functions from national departments to the provincial governments. The main modification was that functions and associated funding and staff were not transferred to provincial governments from the Office of Implementation as soon as the new governments became fully established. Instead, all transfers other than funding for capital works functions (as discussed later) were delayed until the FFR criteria were adjudged to have been met.

The FFR arrangements were put into place immediately (in mid-1978). They applied in all provinces except North Solomons, which -- because staff, funds (and hence activities) had been already transferred to it -- was regarded as having already obtained FFR. In all other provinces, the FFR arrangements applied to funding for all transferred activities except the provincial works programmes. This exception was made because arrangements had already been made for the full transfer of responsibility for and funding of works activities as from 1 January 1978. So even in provinces without FFR, as soon as provincial governments became fully established, the MUG was received in respect of provincial works programmes. All other 'transferred' activities in those provinces continued to be funded through separate national budget allocations to the Office of Implementation (Division 248).

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On the basis that — in theory — the 'transferred' activities were not transferred but instead were being carried out by the national government (through the Office of Implementation), funds for 'transferred' activities could be allocated to the Office of Implementation instead of through the MUG. Further, the funds so allocated did not have to be calculated in accordance with the MUG formula. The reason given was that they were regarded as being allocated to the Office of Implementation and not to provincial governments. As a result, the funds were not appropriated under provincial laws nor dealt with under provincial financial administration laws, nor accounted for by the provinces. Whereas grants to the provinces — such as the MUG — were paid to the provincial governments by cheque, Division 248 funds were paid by warrant authorities under the procedures laid down under the national government's Public Finances (Control and Audit) Act, Chapter 36.

In other words, provincial activities being carried out by staff under provincial control were funded in exactly the same way as if they were activities of national public service departments. Although the funds were accounted for by provincial staff in the provincial BMS offices, they had to be accounted for completely separately from provincial funds, the reason being that they were funds within the national government's financial system — funds allocated to activities of a national public service department (the Department of Decentralisation). The Auditor-General reported on use of the funds as part of his annual report about funds of the national government, rather than in his annual reports on the funds of each provincial government required by s.74 of the Organic Law (see Auditor-General, 1981). (It was in these latter reports that the Auditor-General dealt with grants to the provinces, such as the MUG.) One result of these arrangements was that in provinces without FFR Division 248 funds were handled separately from funds appropriated under the provincial budget — indeed, there were normally two separate accounting systems, the normal government system handling Division 248, and a modified form of the local government accounting system handling funds allocated under the provincial budgets. As a result of the Division 248 funds being beyond their control, provincial politicians tended to take little interest in those funds, concentrating their attention on the provincial budget. As a result of these and related developments, the FFR arrangements have produced some unexpected consequences, which are discussed later in this part of the paper.

As provinces achieved FFR, funding for the transferred activities was no longer provided through Division 248 and was instead allocated through the MUG. The MUG funds were allocated in the national budget through a single line appropriation incorporating the MUG payable to all provinces (Division 289, Special Appropriations). Separate cheques were payable to each provincial government, and the funds were appropriated and expended under the provincial budgets and accounted for as provincial funds.
During 1978, New Ireland and East New Britain joined North Solomons in achieving FFR. Eastern Highlands did so in 1979 and was followed in 1982-83 by Morobe, West New Britain, East Sepik and Madang. At the time of writing the other eleven provinces have yet to be granted FFR.

Summary of Provincial Funds in the National Budgets, 1978-1982

Before completing the discussion of the arrangements in the 1978 to 1982 period, it must be remembered that the arrangements for FFR affected only funding for the transferred activities and so provinces without FFR were in receipt of both the MUG for works and all other transfers from the national government as specified in the Organic Law (derivation and staffing grants and so on). While all national government funds allocated to provincial activities during the 1978 to 1982 period were initially appropriated under the national budget each year, there was a crucial distinction between the transfers provided for in the Organic Law on the one hand, and the funding of transferred activities in provinces without FFR on the other. On the one hand, the former transfers were appropriated as single line appropriations, and then paid by cheque direct to provinces to use as they wished. On the other hand, the funding for transferred activities in provinces without FFR was appropriated and controlled as normal national departmental funds over which provinces had no control.

In the 1978 to 1982 period, the various kinds of provincial government funding allocated in the national budget can be summarised as follows: Division 248 catered for funding of 'transferred' activities in provinces without FFR, and (in 1981 and 1982) for public service salaries in provinces with FFR; Division 289 catered for the main transfers required by the Organic Law, namely the MUG, derivation grant and transfers of national taxes; and Divisions 281 and 282 catered for other grants. These arrangements are described in more detail in Appendix 3. As an example, the arrangements under the Estimates of Revenue and Expenditure for 1982 (Papua New Guinea 1982) are summarised in Table 1. That table, together with all other tables is set out in Appendix 4. Table 1 shows the categories of provincial funding which were allocated under the various divisions of the national budget in 1982. Arrangements for provinces with FFR are compared with those in provinces without FFR. It will be seen that funding under Divisions 248 and 289 was quite different for the two categories of provincial government.

Table 2 shows the amounts of money allocated to each province in 1982 in respect of each of the various kinds of transfer provided for in the Organic Law (allocated under Divisions 281, 282 and 289). Table 3 compares in respect of each province, total revenue from transfers required by the Organic Law with the other four main sources of funding for provincial activities, namely internal revenue, salaries (for members of the public service and the
teaching service), Division 248 and NPEP funding. It will be seen that in 14 of the 15 provinces without FFR the funding for 'transferred' activities provided by way of Division 248 was greater than the total of Organic Law transfers (even after the deduction of salaries from Division 248). As can be seen from column two of Table 3, internal revenue was a significant proportion of total revenue only in North Solomons (15.4%) and Morobe (13.4%) and hence the reliance of the provinces without FFR on funding under Division 248 was very great.

Table 4 compares the four kinds of funding of provincial activities which were processed through provincial BMS offices; that is, all the funds shown in Table 3 except for salaries (which were retained by the national government). But only the transfers provided for in the Organic Law and internal revenue were controlled by provinces and accounted for as provincial funds. Although provincial BMS offices processed Division 248 funds, those funds were controlled by the national government. So this table shows that in 1982, 47.6 percent of the estimated funds for provincial activities handled by provincial BMS offices (Division 248) were not in any way controlled by the provincial governments whose activities that money funded. In all provinces without FFR, other than Manus, Division 248 funding accounted for more than half of the funds dealt with by the provincial BMS offices.

(The arrangements in the national budget for funding of provincial governments changed after 1982, as is discussed in Part Three of this paper. For the purposes of general comparison, the arrangements for 1986 are summarised in Table 5, and the amounts of money allocated under the various divisions in 1986 are shown in Tables 6, 7 and 8. However, because of the changes made after 1982, it is difficult to make precise comparisons between Tables 3 and 4 on the one hand and Tables 7 and 8 on the other.)

FFR and Improved Financial Management

The original intention of the FFR arrangements was that provincial governments should be encouraged to build up their capacities for budgeting and financial management so that they could deal properly with untied grant funding for the transferred activities. It was a corollary of the FFR arrangements that the Department of Finance would take active steps to assist provinces without FFR to improve to the point where they could meet the FFR criteria. Some work along these lines was done in the 1979 to 1980 period. But for some years after that, the department showed little interest in any aspect of provincial financial management other than the management of the Division 248 or Divisions 271 to 290 funding.

8 The NPEP was the National Public Expenditure Plan which operated from 1978 to 1985 (see Footnote 15). All references to the NPEP in this paper include Sectoral Programme funds.
Departmental officials visited the provinces and carried out regular quarterly reviews on those funds while tending to ignore funds allocated under the provincial budgets. So in some provinces, little was done to improve financial management -- yet such improvement was the original aim of FFR. The most likely explanation is that by the early 1980s, the main purpose of the FFR arrangements from the point of view of the Department of Finance was that the department kept control of a large proportion of provincial funding and so improvement of management capacity to the point where that control might be lost, was not of great importance.

Since 1985, however, the Department of Finance (from 1986, Finance and Planning) has been implementing financial management improvement programmes for provincial government personnel as well as for national departments. This development has been prompted by the realisation that government accounting and financial management standards in all arms of government have fallen since independence. The programmes are not directly linked with any plan to achieve FFR in the eleven provinces that have not yet achieved that status. Hence, since the early 1980s, the FFR arrangements have had little connection with their original aims of improving provincial governments' capabilities.

Increasing National Government Financial Control

The FFR arrangements have given the national government a far higher degree of control over funding of provincial activities than was envisaged by the Organic Law. A major proportion of provincial government funding has remained under direct control of the national government and in particular, bureaucrats in the Department of Finance. But the arrangements have also had other effects -- the power of provincial bureaucrats has been increased at the expense of provincial politicians; the provincial bureaucracies have come under greater national control; and the arrangements have caused planning and management problems for the provincial governments. As the FFR arrangements have continued to operate since 1982 in only a slightly modified form (see Part Three), the following discussion is relevant not just to the 1978-1982 period, but to the whole 10 year period, 1978-1987.

The degree of control over funding of the transferred activities exercised by the national government in provinces without FFR is virtually absolute. The funds are kept entirely within the national government's budgetary and accounting system, and so are kept completely separate from funds under the provincial governments' budgets. As national departmental funds, the funds for the transferred activities cannot be dealt with in any way by provincial politicians. The funds are allocated as decided in the national budget, and their actual expenditure is controlled by public servants in the provinces who are accountable officers under the national government's financial legislation. The only provincial government input into the decisions about the amounts
allocated to the transferred activities is made in the form of submissions about proposed budget estimates. Such submissions are generally prepared by senior public servants assigned to the provinces. Because they have no control over the funding for transferred activities, politicians in provinces without FFR tend to ignore the development of policy for, and management of, transferred activities. Instead they tend to concentrate on the funding they do control — namely the provincial budgets. Budgets in provinces without FFR largely provide funding for capital works and maintenance, costs of the provincial assemblies and secretariats, and recurrent funding for a limited range of activities other than the transferred activities funded under the MUG (for example, liquor licensing and local-level government). As a result, provincial politicians in the provinces without FFR tend to take very little interest in the major activities they are ostensibly carrying out — activities such as provision of education, health and primary industry extension services.

This state of affairs is more than acceptable to many senior bureaucrats at provincial level. Their power is much greater than it would be if the funding was under provincial political control. They are able to manage the major recurrent activities with limited political interference — from the budgeting stage through to day-to-day operations. In financial matters affecting the transferred activities, they are, in some cases, answerable virtually only to central government bureaucrats, as if there had been no political decentralisation at all. Most senior public servants in provinces without FFR have little interest in involving the provincial ministers in policy making — they prefer to see the ministers dealing largely with the capital works programme under the provincial budget and leaving the public servants free to operate on their own. So they have little or no interest in encouraging provincial governments to move towards achieving FFR. As national government bureaucrats have no wish to lose their high degree of control of funding in these provinces, there is a clear convergence of interests of the national and provincial bureaucracies tending to block progress towards FFR.

By encouraging provincial politicians to ignore the transferred activities, the FFR arrangements have had the unexpected result of discouraging provincial governments from taking an integrated approach to planning and implementation. They have not been able to deal with all funds used to fund activities notionally under their control. There has been little point in provincial politicians attempting to plan the use of the financial resources they could not control. The lack of an integrated approach to planning on the part of most provincial governments is regarded by many observers as evidence of poor performance by the provincial governments. The contribution that the FFR arrangements have made to this situation has not generally been considered.
The FFR arrangements have brought the provincial bureaucracies under greater national control in other ways. In particular, Provincial EMS offices tend to be treated as national government resources. Yet EMS activities were transferred to provincial control as from 1978 and as a result EMS staff are legally under the direction and control of provincial governments (Organic Law s.47(2)). But because such a large proportion of the funding for provincial activities in provinces without FFR is allocated and accounted for under the national budget rather than as provincial funds, EMS offices have tended to be treated by national government officials as if they were part of the national Department of Finance. (The fact that these offices also act as national government agents also complicates the position). Regular directions on procedures are given by the Department of Finance and Planning. In several provinces, officers responsible for financial matters complain about the extent of direction given.

Finally, the arrangements cause administrative and management problems mainly because they create the need for two completely separate sets of accounts to be maintained in provinces without FFR. This is because the funds for the transferred activities are not provincial funds, and so have to be accounted for separately from provincial funds, as national departmental funds (until 1982, under Division 248 of the national budget, and after 1982, under Divisions 271 to 290). One result is extra work. Extra manpower is needed because two completely separate streams of accounting have to be maintained -- one for provincial funds and the other for national funds. This applies at all stages, from authorisation of expenditure through to writing cheques. (Indeed, each EMS office must have two separate cheque writing machines, one for provincial and another for national funds.) These complex administrative arrangements add to the difficulties any provincial government already faces in attempting to plan and manage the use of provincial resources as a whole.

Reasons for Continuing Operation of the FFR Arrangements

As I have already discussed, senior public servants have little reason to wish for the FFR arrangements to end, because if that happened, the provincial politicians would be in a position to control the transferred activities. Accordingly, there is little doubt that provincial public servants give no encouragement to proposals to move towards FFR. It is not surprising then that the eight provinces which have achieved FFR are amongst those with the most sophisticated political leadership. The politicians in most of those provinces have wanted to exercise control over the whole range of their activities. So the failure of the other 11 provinces to achieve FFR is to some extent an indicator of the weakness of their political arms. However, that weakness is by no means the full explanation, because there is a serious financial disincentive in the way of provinces that might wish to achieve FFR.
The disincentive arises because of the inadequacy of the MUG formula to provide sufficient funding to maintain existing levels of the transferred activities. This inadequacy has long been recognised by the national government, which, as a result, has funded the transferred activities at a considerably higher level in most years in most provinces without FFR than would have been required by the MUG formula (Department of Provincial Affairs 1984: Vol. 2, pp.49-51; Axline 1986b: 96-99). For example, the total additional funding in 1984 was almost K16.5 million over and above the K72.5 million the MUG required should be paid -- an extra payment of almost 23 percent. (Department of Provincial Affairs 1984 Vol.2:p.50, and Tables 2 and 10). In particular provinces, the difference can be very marked -- for example, in West Sepik Province in 1984, the extra payment was 26.5 percent (K2.2 million) more than the amount of K5.2 million payable under the MUG formula (ibid.). The potential loss of income that could result from achieving FFR led the national government to make special grants known as 'differential' grants to the four provinces that achieved FFR in 1982 and 1983. These grants reduced in amount in 1984 and since then have not been increased. On the other hand, funding for the 'transferred' activities in provinces without FFR has risen. So provinces considering applying for FFR status can be assured of a reduction in revenue.

There is little doubt that the likely loss of income has been at least a significant part of the reason why none of the 11 provinces without FFR have attempted to achieve that status since 1983. This is despite the fact that by achieving FFR, provincial governments substantially increase their unconditional grant revenue which can be allocated according to their own priorities. Axline (1986b:99) has summarised the dilemma of provinces without FFR:

'In effect, provincial governments, faced with the inadequacy of the MUG formula, are being forced to choose between the constraint of meeting growing costs of provincial activities with insufficiently growing unconditional grants, and the constraint of leaving the allocation of these resources within the power of the national government with a concomitant higher level of funding'.

The potential loss of income is particularly significant because the provinces without FFR are generally amongst the less developed. Analysis of the results of a 1985 study on levels of inequalities in development of districts9 and provinces shows that provinces without FFR held six of the seven lowest ranked positions when comparisons of a wide range of indicators of development levels

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9 The 87 districts are sub-provincial units of area. Prior to independence, when what are now 'provinces' were known as 'districts', the present districts were known as 'sub-districts'.
were made (de Albuquerque and D'Sa 1985: Table 10). The 1984 'Specialist Committee' found that the additional funding above that required by the MUG paid to provinces without FFR 'has had the effect of equalisation through redistribution towards the less developed provinces' (Department of Provincial Affairs 1984: Vol. 2, p.51). The same review found that there were no other major sources of funds with an equalising effect. As less developed provinces generally have no significant sources of revenue other than transfers from the national government, this factor alone may make it very difficult for them to consider applying for FFR.10

Conclusion

The FFR arrangements served a useful purpose when they were introduced. The period when provincial governments were being established was one of great administrative confusion. The difficulties of establishing the new system were probably underestimated by both McKinsey and Co. and the NEC. Transfer of funding before proper financial management systems were established could have been disastrous. The introduction of the FFR arrangements provided a breathing space, and allowed financial management systems to gradually become established and operational. However, once the systems were operating, little was done to encourage the provinces to move to FFR status, and the arrangements for provinces without FFR became institutionalised. This was due to a convergence of bureaucratic interests at both the national level and in many of the provinces without FFR and also to financial disincentives in the way of provinces seeking FFR.

10 Most of the provincial governments in question are amongst those generally regarded as having few experienced and trained personnel and having considerable management difficulties. Four of the eleven have been suspended -- Enga and Manus in 1984, and Simbu and Western in 1985. The ground for suspension in each case was gross financial mismanagement, which suggests that insufficient attention has been given by the national government to the management problems of these provinces. Greater support could be given by the national government, either by using its powers under s.49 of the Organic Law to assign more experienced and competent staff, or by providing management training and other forms of support.

As from 1983, allocations of funds for transferred activities in provinces without FFR ceased being made through Division 248, (Office of Implementation) and instead were made through new national budget divisions created for the 19 public service 'departments of the provinces' - Divisions 271 to 290. This part of the paper describes how the FFR arrangements have been continued through these new budget arrangements. More importantly, it describes how, by using Divisions 271 to 290, the national government has been able to greatly expand the range of provincial activities, funding for which is retained completely within the national budgetary and accounting arrangements. The significant change with these wider arrangements is that they apply equally to provinces with and without FFR status. So the period has seen a major increase in national government control of funding of provincial activities in all provinces.

Departments of the Provinces and Divisions 271 to 290

The McKinsey and Co. mechanism for transfer of activities involved the transfer to provincial governments of the designated activities together with the funding and staff needed to carry them out. While the FFR arrangements were developed by the Department of Finance with the aim of delaying transfer of control of these funds until provincial governments were capable of properly managing their finances, at the same time the Public Services Commission was coordinating efforts to develop a way of effectively transferring to the provinces control over staff carrying out activities classified as provincial. This was done by establishing a public service department for each province, and transferring the staff carrying out transferred activities from the positions they notionally occupied in the Office of Implementation to positions in the 19 new provincial departments. The departments were officially established in April 1979 (see National Gazette No.G.22, April 12 1979, p.265), but the process of approving their internal structures and transferring staff into positions in those structures was not completed until 1982.

With the full establishment of these departments, there were no longer staff in the Office of Implementation carrying out activities designated as 'transferred'. As a result, funding for the 'transferred' activities could no longer be allocated to that Office via Division 248. So the Department of Finance now used the fact of the establishment of the departments of the provinces as the basis for continuing the FFR arrangements. The rationale for the new approach was that the departments of the provinces were exactly the same as other public service departments (for example, Department of Education) and that allocations of funds could be made to them, through the national budget. Such allocations could then be treated entirely as national departmental funds. This would enable the Department of Finance to retain full control of the funds.
Hence as from the 1983 Budget, Division 248 was discontinued, and separate budget divisions were created for each of the departments of the provinces. These new divisions were designated Divisions 271 to 290. They have been used to continue the FFR arrangements — funding for 'transferred' activities (other than works) continues to be allocated through those divisions rather than through the MUG. As a result, provinces without FFR have continued to have no control over the funds allocated to their major activities. In provinces that have achieved FFR, funds for 'transferred' activities continue to be provided through the MUG, paid under Division 298. The only exception is the salaries component of the MUG (in respect of assigned public servants and teachers in provincial schools) which is now allocated through Divisions 271 to 290.

The departments of the provinces were established by the Public Services Commission with the major intention being to give provincial governments control of the public servants carrying out the provincial functions. It is therefore ironic that the Department of Finance was able to use the creation of the new departments to retain control of the funding of the functions carried out by those same public servants in provinces without FFR.

Whereas in the 1978 to 1982 period, Division 248 had mainly catered for funding of the so called transferred activities in provinces without FFR, in the 1983 to 1987 period, Divisions 271 to 290 have been used to fund additional activities in all provinces, including provinces with FFR. As a result, Divisions 271 to 290 cater for seven distinct categories of funding:

(a) 'transferred' activities in provinces without FFR;
(b) salaries of assigned public servants in provinces that have been granted FFR;
(c) minor power houses in all provinces (except Manus);
(d) new and ongoing projects in all provinces;
(e) as from 1986, the former community school sectoral programme in provinces with FFR;
(f) 'delegated' health functions in all provinces; and
(g) cash crop marketing.¹¹

The development and operation of the arrangements for funding each of these categories is now discussed separately. The expansion of the application of Divisions 271 to 290 has happened gradually, and almost certainly without there being a clearly expressed intent on the part of the Department of Finance or other national government authorities that the divisions be used to increase

¹¹ There was a minor additional category in the period from 1983-1985 namely funding for village courts officers. As that category was transferred to the Department of Justice in 1985, it is not discussed in the paper.
national control of provincial financing. So it is illustrative of the way a central bureaucracy operates to examine in some detail the development and operation of the new funding categories controlled under Divisions 271 to 290; that is the categories other than funding for transferred activities in the provinces without FFR. Of particular interest is the way apparently inconsistent reasoning has been used by national government authorities to justify the extension of Divisions 271 to 290 to the various categories of funding. Some categories of funding are allocated through Divisions 271 to 290 on the basis that it is a public service department, completely separate from the provincial governments (for example, minor power houses and funds for 'transferred' activities in provinces without FFR). Other funds are allocated through those divisions even though they are clearly acknowledged to be conditional grants to the provincial governments (for example, New and Ongoing Projects funding). This inconsistency suggests that Divisions 271 to 290 are used whenever it is convenient to the national government to do so and that considerations of the intentions or the legal requirements of the Organic Law are of little concern.

'Transferred' Activities in Provinces without FFR

Since the introduction of Divisions 271 to 290, the FFR arrangements have continued to operate in much the same way as they did until 1982. Only the rationale upon which the national government bases its continued use of these special arrangements for funding 'transferred' activities in provinces without FFR has changed. The rationale is that the departments of the provinces are regarded as legal entities separate from the provincial governments they serve. They are regarded as departments within the national public service. As a result, allocations of funds to them under Divisions 271 to 290 can be made in the same way (and must also be dealt with, accounted for and audited in the same way) as allocations to national public service departments (for example, the Departments of Education, Police or Minerals and Energy). But as has already been discussed, the main purpose of establishment of the departments of the provinces was to transfer effective control of public servants to the provinces. The departments were not established as funding mechanisms. Their existence does not provide a proper basis for the FFR arrangements. Indeed, as is discussed later in this paper (Part Four -- Some Legal Considerations), in a 1981 opinion, the Department of Justice regarded the creation of the departments as resulting in the legal transfer of activities to provinces without FFR -- hence removing any legal basis that previously existed for the FFR arrangements. Thus even if the departments of the provinces were valid legal entities, their existence would not provide a basis for FFR. But, in fact, a 1984 Supreme Court decision in a case known as the 'Morobe Case' has made it clear that
the departments of the provinces are unconstitutional. Thus there is no valid theoretical basis for funding transferred activities in non-FFR provinces under Divisions 271 to 290.

Public Service Salaries in Provinces with FFR

The allocation under Divisions 271 to 290 of salaries of assigned public servants in provinces with FFR is made on the basis that those public servants are employed in the departments of the provinces. It is normal practice for personal emoluments of public servants to be allocated to the department in which they serve. The 1984 Supreme Court decision in the Morobe case has some implications for these arrangements (as discussed in Part Four).

Minor Power Houses

At the 1982 Premiers' Council Conference in Arawa, the national Department of Finance proposed that responsibility for the 140 minor power houses in rural areas be transferred to provincial governments. It was proposed that responsibility would initially be limited to financial matters: billing customers, collecting fees, and payment to the Papua New Guinea Electricity Commission for maintenance. The bulk vote for these power houses in the 1982 Estimates of Revenue and Expenditure was to be distributed amongst provinces as from 1983. Initially funds would be allocated as conditional grants, but eventually would become part of the MUG (Premiers' Council 1982: 158 to 160). If accepted, the proposal would have had the immediate effect of making provincial EMS staff responsible for accounting and financial control of the power houses and in the long term, the provinces would have assumed full responsibility for their funding and management.

The Premiers' Council, by formal resolution, rejected the proposal on the basis that in the long term it would make the provinces liable for unforeseeable costs such as replacement and expansion of facilities. They suggested that the Papua New Guinea Electricity Commission was the body best equipped to take over responsibility for the power houses. The resolution noted '...that if Elcom is unable to accept the scheme as offered by the Department of Finance it would presumably be due to the lack of viability of the scheme' (Premiers' Council Resolution No. PC 16/5/82).


Apparently the national government accepted the Premiers' Council Resolution in 1983 and 1984, but in 1985, 1986 and 1987, minor power houses maintenance funding has been added to Divisions 271 to 290. According to a senior official of the section of the Department of Finance and Planning responsible for provincial finances, the main reason for the allocations for minor power houses being directed through Divisions 271 to 290 is budgetary convenience. The arrangement is not seen as breaching the 1982 Premiers' Council resolution because allocations under Divisions 271 to 290 are made to the departments of the provinces, which the national government views as entities separate from the provincial governments. The official advised that the Department of Finance and Planning would prefer to fund minor power houses by way of grants to the provinces under Divisions 292 or 298, as with town services grants (see Tables 1 and 5), but cannot do so because the provinces have not agreed to the function being transferred to provincial control (personal communication, August 1986).

In effect the Department of Finance has achieved much of what it proposed to do but which was rejected by the Premiers' Council in 1982. By allocating funds through Divisions 271 to 290, BMS offices in the provinces must handle the accounting. To date, provinces have not made serious objection because they are already handling so much national government accounting that a little more makes little difference. Further, the major concern of the premiers in 1982 was to avoid taking financial responsibility for minor power houses. Funding under Divisions 271 to 290 leaves the national government clearly responsible. As they have so far been protected from financial exposure, provinces have not been unduly alarmed by the funding arrangements. On the other hand, the funds for minor power houses are allocated to the departments of the provinces under Divisions 271 to 290 in the face of provincial government refusal to take on responsibility for the function and its funding. This is despite the fact that the BMS staff in those departments who now handle the accounting are clearly under provincial direction and control. Some provincial finance officials believe that this indicates that the Department of Finance and Planning treats the Bureau of Management Services offices in the provinces as public service units which it controls -- a matter of some resentment in some provinces.

New and Ongoing Projects (NPoP)

Since the establishment of the provincial government system, most national government funds which have not been committed to its recurrent expenditure and which might otherwise have been available for allocation to provinces as additional unconditional grants (OLPG

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14 Since 1985, the only province for which there has been no allocation for minor power houses has been Manus, there being no minor power houses in that province.
have instead been allocated as National Public Expenditure Plan (NPEP) or, since 1986, 'New and Ongoing Project' funds. Provincial governments have had to compete for these funds along with national agencies. The process of preparing and submitting NPEP/New and Ongoing Project proposals has always been complex, and it was evident in the early years of operation of the NPEP that better developed provinces were more successful than others in preparing and submitting proposals. This was largely due to the fact that these provinces had more skilled personnel.

To redress the balance, NPEP sectoral funds were introduced out of which small-scale projects were funded, generally in less developed areas. Less complex procedures applied to those funds than to other NPEP project funds. The proportion of NPEP funds allocated to provincial governments (inclusive of NPEP project funds and sectoral funds) was never very great—between 1980 and 1984 about 16 percent of total funds (Department of Provincial Affairs 1984:Vol.2, pp.54-55). However, because levels of funding through the main unconditional grant to provinces with FFR (the MUG) have been inadequate to maintain existing activities, and as additional unconditional grants were negligible to 1984 and were discontinued as from 1985, NPEP and New and Ongoing Project funds have been an important source of funding for provincial priorities.

The National Public Expenditure Plan (NPEP) operated from 1978 to 1985. A modified version of the NPEP was in preparation in 1984 and 1985 and planned for introduction in 1986. To be called the Medium Term Development Programme (MTDP), its aims were to be similar to the NPEP, but certain modifications were planned. The MTDP was to extend the planning cycle from four to five years, new government policy objectives were to be developed and adopted, and each key national department was to develop sectoral strategies within which project proposals were to be developed. With the change of national government in late 1985, the MTDP as a name, was no longer used. However, many of the changes to the NPEP proposed for inclusion in the new programme were taken up in the new planning approach introduced with the 1986 Budget in March 1986. The new planning approach has not been given a special name. The main principles are set out in Budget Document No.1 entitled 'Planning and Budgetary Strategy' (Papua New Guinea 1986a). All details of non-recurrent project expenditure of the type that was formerly classified as NPEP funds are dealt with in a special budget document entitled 'New and Ongoing Projects' (Budget Document No.3) (Papua New Guinea 1986c). Similar arrangements apply in 1987. In 1988, the five-year 'Public Investment Programme' replaced 'New and Ongoing Projects' (Papua New Guinea 1987).
NPEP funds allocated to provincial government projects and through the sectoral programmes have always been regarded as conditional grants payable under s.65 of the Organic Law. Conditional grants are payable by the national government for any purpose agreed on by the national government and the province and are subject to any agreed conditions. The process of submission and approval of NPEP projects has ensured clear agreement on the purposes of these grants, and informal understandings have often been reached as to conditions attached to them. Formal agreements have been rare, except in the case of sectoral programme funds in respect of which, in recent years, very general and broad agreements have often been prepared. These agreements are signed by the Minister for the national department concerned (for example, Health or Education) and by the premier for the province concerned. In some cases, conditions attached to these grants include payment of matching contributions by the province concerned, and such conditions are recorded in the signed agreements.

As discussed in Part One of this paper, the Organic Law envisages that provincial funds (including conditional grants) will be dealt with through provincial finance systems. But even though the NPEP funds have always been understood to be conditional grants, they have nevertheless been kept within the national government financial system in much the same way as funds for transferred activities in provinces without FFR. Until 1982, NPEP funds were allocated through single line 'items' in Division 281 or 282. These 'items' included all funds for the projects -- capital works, salaries, etc. Department of Finance and Planning officials say that this method of funding caused two problems. First, it created difficulties in monitoring expenditure and project performance. As provinces would account for the grants by simply opening one-line ledgers, there was difficulty in getting detailed reporting of the expenditure. Second, it caused accounting problems in dealing with salaries of public servants working for provincial governments whose salaries were paid from NPEP funding. As these salaries were not deducted from the HUG, they were not allocated under Division 248 -- the division which funded all other assigned public servants' salaries (Department of Finance official, Personal Communication, August 1986).

As a result, from 1983 onwards, largely in the interests of simplifying its accounting procedures and achieving greater accountability for NPEP funds, the national government has

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16 For example, the 1984 Specialist Committee Report discussed NPEP funds under the heading 'Conditional Grants' (Department of Provincial Affairs 1984: Volume 2, pp.54-55, 74-84). In 1986, funds for provincial projects funded as New and Ongoing Projects were similarly prescribed in the national budget documents -- for example, project No. 272-32-801/83 for Rural Health Improvement (Papua New Guinea 1986c).
appropriated these funds through Divisions 271 to 290. The funds are not appropriated under provincial budgets (except for part of the funding received by North Solomons as discussed later). As with the FFR arrangements, the result is a considerably increased complexity in provincial government accounting for all provincial governments. For the 1986 fiscal year, for example, a detailed breakdown of the New and Ongoing Project Funds appeared in Budget Document No.3 (Papua New Guinea 1986c) on a project by project basis, and in the Vote Index (Papua New Guinea 1986d). In each province, the BMS office must account for the funds as national departmental funds on the same itemised basis on which the projects are set out in Budget Document No.3 and the Vote Index. Some of the sectoral programme funds involve kina for kina contributions from the provincial government. In such cases, provincial governments' accounting problems are especially complex, as some funding comes through the provincial budget and some through the department of the provinces allocation under one of the Divisions 271 to 290. These funds are regarded as conditional grants to the provinces, yet they are treated quite differently from other conditional grants (for example, grants for town services) which are paid direct to the provinces through Division 292 and appropriated in provincial budgets.

The absurdity of these arrangements is illustrated in the way that the North Solomons Provincial Government, evades some of the accounting problems caused by these funds being treated as national funds. This is done by using the authority of the Secretary of the Department of North Solomons as a 'financial delegate' under the Public Finances Management Act, Chapter 36. His maximum delegation under that Act is K20 000. When the BMS Office in Arawa receives Cash Fund Certificates under the 'Department of North Solomons' division in the national budget (Division 290) for projects which involve expenditure on capital works only, and not on payment of public servants salaries, the Secretary authorises transfer of the funds from Division 290 to the provincial government by means of a series of K20 000 cheques. The provincial government then appropriates those funds in its annual estimates of revenue and expenditure. The funds are then accounted for to the national government in two ways:

- as Division 290 funds by means of a simple series of one-line payments of K20 000 to the provincial government; and
- as provincial government funds appropriated under provincial law.

Some sectoral programme funds and some provincial NPEP project funds are also allocated through the votes of particular national departments. For example, Community Education Sectoral Programme funds were allocated under Division 203 in the 1982 Budget (National Planning Office 1982:57).
In this way, the largest possible proportion of funds is put through the provincial accounts. By reducing the volume of funds accounted for as national, extra work for the EMS office is reduced. (This approach is not possible with project funds which involve payment of public service salaries because of accounting complexities involved in disaggregating the salaries component.) The result is that the provincial government continues to be accountable, but reduces the work and complexity that the system otherwise entails.

There is a clear inconsistency involved in funding provincial NPEP projects through Divisions 271 to 290 of the national estimates of revenue and expenditure. On the one hand, the theoretical basis for using those divisions for the allocation of funds for both transferred activities in provinces without FFR and for the minor power houses is that in some way, the departments of the provinces are legal entities separate from provincial governments. So allocation of funds to the departments is not regarded as allocation to provincial governments. On the other hand, the national government clearly accepts that funds for provincial NPEP projects and sectoral programme funds are conditional grants to provincial governments. While the intent of the Organic Law is that grants should be dealt with through independent provincial financial systems, the desire to keep national control of NPEP funds has made Divisions 271 to 290 a convenient mechanism to use, and as a result the requirements of the Organic Law are ignored.

Community School Sectoral Programme

The Community School Sectoral Programme was introduced as part of the NPEP as from 1979 with the aim of gradually building enough community schools to achieve universal primary education (National Planning Office 1980:98; Bray 1984:57-63). The programme also provided funding for the salaries of teachers in the new schools and other recurrent costs. With the expiry of the programme in 1986, the source of funds for continuing payment of the recurrent costs had to be decided. Salaries of public servants and teachers carrying out transferred activities are deducted from the MUG in provinces with FFR. No such deduction could be made in this case, as these schools had not been operated by the national government in the 1976-77 year, and so could not be classified as part of a transferred activity within the definition in Schedule 1.1. of the Organic Law. The 1984 review of provincial financial arrangements had recommended that when NPEP projects ceased being funded under the NPEP, ongoing recurrent costs (including salaries) should continue to be a national government responsibility, payable to provincial governments by means of 'one-line conditional grants' (Specialist Committee Report 1984: Vol. 1, p.12; Vol. 2, p.77). With the intention of meeting this recommendation, as from its 1986 budget, the national government commenced using Divisions 271 to 290 for allocation of recurrent costs for the schools built under the Community School Sectoral Programme. In other words, the funds are regarded as being conditional grants to the provinces. But as is
the case with NPEP funds, the use of Divisions 271 to 290 clearly defeats the Organic Law's intent that conditional grants be dealt with as part of a provincial government's budgeted funding.

Delegated Health Functions

The 1977 NEC decisions about transferring activities included directions that, as from 1 July 1978, responsibility for various activities of the national Department of Health were to be transferred to the Ministry of Decentralisation, and thence on to provincial governments. Some activities were to be fully transferred -- in the main, rural health services. Others were to be 'delegated' and these included provincial hospitals, ambulance services and a number of other functions. The NEC decision was not clear about the distinction between 'transfer' and 'delegation' of activities. As a result, confusion arose, particularly over the status of the delegated activities. That confusion alone would have been enough to delay the transfer process, but in addition there was deep-seated opposition to decentralisation in the senior levels of the Department of Health and the general feeling was that the department was 'determined not to relinquish control', despite the NEC decisions (Reilly 1985:149). As a result, the department largely ignored the NEC decision. Unlike most other national departments whose functions were to be transferred, the department retained control of staff -- even some of those carrying out the functions directed by NEC to be fully transferred. Most health staff were not brought into the Office of Implementation (Department of Decentralisation) even on a notional basis. However, funding for the functions ordered to be fully transferred (rural health services) did become part of the MUG in FFR provinces and were funded through Division 248 and (later) divisions 271 to 290 in provinces without FFR.18 But until 1983, the delegated health activities continued to be funded through the national Health Department's appropriation in the national budget, and in respect of those activities, transfers of funding to the provinces were not made even when FFR was achieved.

From 1978 to 1982, the senior Health Department officials in the provinces (provincial health officers) gradually found more and more difficulty working with the highly centralised, bureaucratic and inefficient procedures in the national Department of Health. Difficulties arose in all areas of their work — particularly recruitment and discipline of staff and obtaining of funds. Even minor matters had to be referred to the Konedobu headquarters resulting in inordinate delays. The fact that health staff carrying out delegated activities were not brought under provincial control caused particular difficulty, especially once the departments of the provinces were being established, between 1979 and 1982. Disagreements then developed between on the one hand, provincial health officers and provincial governments, and on the other hand, the Health Department, about the exercise of disciplinary and control powers over health staff in the provinces.
The Public Services Commission took the view that the 1977 National Executive Council decisions on transfer of activities required that health staff carrying out both the delegated and transferred health activities should be part of the departments of the provinces. The Secretary of the national Department of Health disagreed. The major pressure for transferring responsibility for the delegated health functions came from senior health staff in the provinces rather than from provincial governments — largely because the health staff in the provinces believed health services would be better managed at the local level than through a monolithic bureaucratic department (ibid.:65, and 111-127).

In mid-1982, largely in an effort to resolve the impasse between the Health Department and provincial health staff, the National Executive Council directed that in respect of certain 'national health functions' (largely those previously classified as 'delegated'), arrangements were to be made to transfer 'administrative responsibility' to the provincial governments as from 1 January 1983. Necessary funds were to be provided directly to the provincial governments as from 1 July 1983. Department of Health staff engaged on those functions were to transfer to positions in the provincial departments (NEC Decision No. 65 of 1982). This decision did not clearly resolve the question of ultimate control of either the delegated activities or their funding. In his 1983 national budget speech, the then national Minister for Health (Mr M. ToVadak) said that 'delegation of administrative control...does not and will not result in their transfer to the provinces...these functions and ultimate responsibility for them will remain national' (Hansard, 23/11/82 at page 21/11/14). In other words whatever their role was to be, provincial governments were not gaining full control of the functions. Further, the functions were not being 'transferred' for the purpose of Schedule 1. of the Organic Law, because in all provinces, funding for the delegated health activities is provided through Divisions 271 to 290, rather than through the MUG. However, all funding for the previously transferred health functions ('rural health services') other than salaries, continues to be paid through the MUG in provinces that have achieved FFR.

Some provincial governments were unhappy about the decision to delegate control of health functions as from 1983, particularly as the functions to be delegated included the administration of provincial hospitals. They were concerned that the funding necessary to run the hospitals properly might not be made available by the national government once the delegations went ahead. In particular, there was concern that the delegated health functions might be funded under the MUG which would require use of 1976-77

18 The transferred health functions are the present 'rural health services' functions. They are now funded under Divisions 271 to 290, Activity 1, Function 2 (Papua New Guinea 1986b).
funding levels as a base. As there had been considerable expansion of activities in some hospitals since 1976-77, MUG funding levels would be inadequate to maintain the hospitals. As a result, the provinces wanted funding arrangements clarified and improved before they would consider taking full financial responsibility for the activities. For that reason, the 1982 Premiers' Council conference passed a resolution requesting deferral of transfer of responsibility for the delegated functions (Premiers' Council Resolution No. PC 31/5/82). Once provinces were assured that the national government would, for the time being, retain financial control, they did not make further objections and a resolution of the 1983 Premiers' Council conference endorsed the National Executive Council decision of mid-1982 (Premiers' Council Resolution No. PC 4a/6/83). Since then funding has been provided under Divisions 271 to 290.

These funding arrangements have not been changed between 1983 and 1987, and so the basis upon which provincial governments carry out the delegated health functions is far from clear. As provinces control the staff carrying out the functions, it can be argued the activities have been transferred, in which case they should be funded under the MUG. However, provinces do not want them to be so funded while MUG funding is based on 1976-77 level of activities.

Lack of certainty as to who has ultimate responsibility for the delegated health functions is causing practical problems in some provinces. For example, in Morobe, funding agreements between church health agencies and the State, entered into prior to 1982 (when the delegated health functions were a national responsibility) expired in 1986. Government funding for the activities of these agencies had become part of the funding for the delegated health functions under Divisions 271 to 290. The agencies wished to enter into new agreements. The national Department of Health advised that the functions had been transferred to the Morobe Provincial Government and so agreements should be signed with the province. But as the funds for these activities had not been allocated unconditionally, it was not certain who had responsibility for negotiating and signing new agreements, especially as such agreements would probably result in higher funding levels being needed. If additional funds were needed, and the national government remained responsible for funding decisions, should the national government negotiate and sign the agreements? Clearly, there are practical reasons why the status of the delegated health functions should be clarified.

As the national government accepts that provinces are carrying out the delegated health functions, the basis for the arrangements

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19 Church health agencies are funded under Divisions 271 to 290, in each case through 'Function 2, Activity 6 - Church Health Services' (Papua New Guinea 1986b).
for funding those functions under Divisions 271 to 290 cannot be
that the departments of the provinces are separate legal entities
from their provincial governments. So presumably the basis is
simply that used to fund New and Ongoing Projects under the same
divisions -- namely that the national government wishes to keep
control of the funds. Although the national government has not
explicitly stated it to be the case, it seems likely the funds are
regarded as conditional grant funds, similar to the funds for New
and Ongoing Projects.

Cash Crop Marketing

Cash crop marketing involves a service provided to small rural
farmers, generally in remote areas, whereby primary industry
extension officers purchase cash crops directly from farmers for
subsequent resale through normal markets. Until 1982, the service
was carried out by agriculture extension officers assigned to
provincial governments, but was funded through the national
Department of Primary Industry. From 1983, the NEC decided that
funding should be allocated through the departments of the
provinces. Provincial governments were generally supportive as they
regarded the cash crop marketing service as a useful one. Further,
the funding for the scheme is, in many cases, virtually a subsidy.
The scheme is intended to be self-financing -- through an
appropriation in aid -- but in most cases, the costs of sending
purchasing officers to remote areas far outweighs the returns
obtained when the produce is subsequently marketed.

The rationale of allocating the cash crop marketing funds
through Divisions 271 to 290 is apparently that the funds are
allocated to the departments of the provinces in order to facilitate
their work. However, cash crop marketing was an activity carried
out by the national Department of Primary Industry in the 1976-1977
fiscal year (Papua New Guinea 1976:54). Once it became an activity
carried out by staff under provincial control, it became a
transferred activity and so should have been funded under the MUG,
as required by Schedule 1 of the Organic Law.

Summary of Provincial Funds in the National Budgets, 1983-1987

Before completing the discussion of Divisions 271 to 290, it
must be remembered that although from 1983 to 1987 an increasing
range of funding has been allocated under those divisions, other
kinds of provincial funding have continued to be provided through
other divisions of the annual estimates of revenue and expenditure.
During this period, the way these other allocations have been made
has varied only slightly from year to year. For example, it is
helpful to examine the arrangements under the 1986 Budget (Papua New
Guinea 1986b). In 1986, all unconditional grants payable to all
provinces were paid through Divisions 292 and 298 of the national
budget: Division 292 catered for the small staffing grants (s.51 of
the Organic Law) and various other small grants, both conditional
and unconditional; Activity 2 of Division 298 provided for the grants pre-appropriated under s.68 of the Organic Law (the MUG, derivation grant and transfers of national taxes); and Activity 3 of Division 298 provided for the salaries of teachers in provinces with FFR.20

These arrangements are summarised in Table 5. In particular, the table compares the arrangements for provinces with FFR and those without FFR. Comparing Table 1 with Table 5, the changes in allocation of funds from 1982 to 1986 can be seen at a glance. Comparing Table 1 with Table 5, the expansion of national control can be seen at a glance. Whereas in 1982, Division 248 catered only for public service salaries in provinces with FFR and funds for the 'transferred' activities in the others, in 1986, the divisions which replaced it (Divisions 271 to 290) catered for the additional kinds of funding just discussed (minor power houses, New and Ongoing Projects and so on).

Table 6 shows, in respect of each of the various kinds of grants from the national government, the amounts allocated to each province under Divisions 292 and 298. Comparing the position in 1982 — as shown in Table 2 — with the position in 1986 — as shown in Table 6 — it will be noted that the four provinces which achieved FFR in 1982 and 1983 were deriving a significantly increased proportion of their income from grants in 1986 as compared to 1982 — a direct result of achieving FFR (Morobe, Madang, East Sepik and West New Britain). Table 7 compares total grant funding with other sources of funding for provincial activities, namely internal revenue, salaries (of members of the public service and teaching service), and Divisions 271 to 290. The significance of funding under Divisions 271 to 290 will be noted, particularly in the 11 provinces without FFR. In nine of these provinces, Divisions 271 to 290 accounted for a greater proportion of funding of provincial activities than did grants from the national government. This can be seen by comparing columns one and four in Table 7. As can be seen from column two of the same table, in most provinces, internal revenue did not contribute a significant proportion of funding. Hence, the reliance on funding under Divisions 271 to 290 was very great. Table 8 compares the three kinds of funding of provincial activities that were processed through provincial RMS

20 Arguably, funds for teachers' salaries should be paid as part of the MUG. Although Schedule 1.3. of the Organic Law specifically provides for deduction of public service salaries from the MUG, it does not make the same provision for teachers, all of whom are members of the Teaching Service Commission. However, it is likely this omission was a drafting oversight rather than a policy decision. It is clearly within the spirit of the scheme of the Organic Law that both sets of salaries are retained by the national government.
offices; that is, all the funds shown in Table 7 except for salaries (which are retained by the national government). This table shows that in 1986, 31.1 percent of the estimated funds handled by provincial RMS offices comprised funds that the provincial governments did not control, namely the funds under Divisions 271 to 290.

Increasing National Government Financial Control

The period since 1982 has seen a considerable growth in national government control of the funding of provincial activities. This has been achieved through the use of Divisions 271 to 290 to extend funding arrangements similar to the FFR arrangements for the funding of a much wider range of activities and in all provinces — not just the 11 provinces that have not achieved FFR. The points made in the earlier discussion about the growth of national control through use of the FFR arrangements also apply when considering the use of Divisions 271 to 290. The funding arrangements under those divisions:

- bring a high proportion of funding of provincial activities under direct national control;
- give greater power to provincial bureaucrats at the expense of provincial politicians;
- help to bring provincial bureaucracies under greater national bureaucratic control; and
- cause major planning and administrative problems for provincial governments.

There is little need to enlarge upon the points already made when discussing these issues in relation to the FFR funding arrangement. But two points require some comment. First, the problems caused by Divisions 271 to 290 are not as great in provinces that have achieved FFR. This is particularly the case with the problem of increasing power of provincial bureaucrats. As the provincial politicians in provinces with FFR are already in control (through the provincial budget) of the major proportion of funding for the transferred activities, the expansion of funding under Divisions 271 to 290 has not been sufficient to alter their overall control of activities.

Second, the planning and administrative problems caused by the wide range of functions funded under Divisions 271 to 290 are on a far greater scale than was the case with the FFR arrangements until 1982 — particularly in provinces without FFR. The reason is simply that all provincial governments must account for an ever growing proportion of the funding available for their activities as if the funds were national departmental funds. Their independent financial systems, established under the Organic Law, are dealing with reducing proportions of the total funding of provincial activities. This can be seen in a general way by comparing Table 4 and Table 8. One result is a considerable increase in complexity in accounting
arrangements for all provincial governments. Prior to 1983, provinces without FFR had to account for only transferred activity funding as national funds.

Since 1983, they have had to deal in the same way with the additional categories of funding just discussed. Although the volume of funding going through Divisions 271 to 290 is lower in provinces with FFR, the same administrative problems are caused by the fact that those funds have to be treated separately from provincial funds. Provincial finance officers in four provinces with whom the situation has been discussed, have indicated that the growing amount of funding which they are required to process as national funds creates a great deal of extra work for them (Finance officers from Manus, New Ireland, East New Britain and North Solomons, personal communications, August 1986). Two completely separate sets of accounts have to be maintained—one for funds appropriated under the provincial budget and another for funds appropriated under Divisions 271 to 290. Completely separate streams of work are maintained in all BMS offices for checking requisitions, authorising payments (and all other steps required by both national and provincial financial administration laws). There continue to be separate cheque writing machines in each provincial BMS office—one for provincial funds and another for Divisions 271 to 290.

The results are not only extra work, but also employment of additional staff, confusion and inefficiency. Equally importantly, the almost total separation of Divisions 271 to 290 from provincial budget funds makes it impossible for provincial governments to plan and manage their resources as a whole. The above-mentioned provincial finance officers advise that they believe that if the Divisions 271 to 290 funds were amalgamated with provincially appropriated funds, there would be improvement in efficiency of BMS offices and reduced manpower requirements. These opinions are supported by officials of the Programme Management Unit in the Department of Finance and Planning (personal communications, October 1986).
PART FOUR: SOME LEGAL CONSIDERATIONS

The basis for much of the discussion so far has been the view that the growing national government financial control is contrary to the spirit of the decentralised arrangements embodied in the Organic Law and has caused serious planning and management problems -- all of which suggests that changes should be made. But in addition, there are strong grounds for arguing that the arrangements offend the Organic Law and as a result are unconstitutional.

Legal Basis for FFR Arrangements

The original legal basis for the FFR arrangements was that the 'transferred' activities, together with associated funds and staff had been transferred to the Office of Implementation as from January 1978 (see Footnote 6). Although staff carrying out the activities in question were in fact answering to the provincial governments, they were officially filling positions in the Office of Implementation. While responsibility for the activities and staff was vested in the Office of Implementation and not in the provinces, the activities were not 'transferred' within the meaning of Schedule 1, of the Organic Law and so did not have to be funded under the MUG.

Any legal basis for the FFR arrangements was destroyed by the official transfer of control of public servants from the Office of Implementation to the provincial governments, which occurred with the full establishment of the departments of the provinces. The transferred activities were then clearly no longer being carried out by the Office of Implementation. In 1981, the Department of Justice advised the Auditor-General that this meant the activities were being carried out by, and so were fully transferred to, the provincial governments (Auditor-General 1981:18). The Department of Justice opinion was based on the argument that if a provincial government controlled and directed the public servants who were carrying out an activity, then the provincial government was itself 'carrying out' the activity. The activity then became a transferred activity for the purposes of calculating the MUG (ibid.). At that point, in the absence of any amendment being made to the Organic Law to give recognition to the FFR arrangements, the activities should only have been funded under the MUG. Hence, the FFR arrangements were without any legal basis and that continues to be the position.

The Organic Law provides an avenue which the national government might have used to give a legal basis to the FFR arrangements. The procedures under ss.100 and 101, for graduating the powers of provincial governments, could perhaps have been used to hold back the financial powers and resources which should have flowed to the provinces once the 'transferred' activities became fully transferred. But there is no evidence that such an approach has ever been considered.
Legal Basis for Funding under Divisions 271 to 290

As some different considerations apply to the legal basis—or lack of it—for the seven kinds of funding allocated under Divisions 271 to 290, each of them is examined separately.

(a) 'Transferred activities' in provinces without FFR

As already discussed, the progressive establishing of the departments of the provinces, completed by late 1982, clearly destroyed the legal basis for the FFR arrangements. Although this was not recognised by the national government in its funding arrangements, the fact was made abundantly clear by the Supreme Court decision in the Morobe Case (August 1984). As already discussed, until then it seems to have been assumed that the separate legal entities thought to have been constituted by the departments of the provinces gave some legal basis to continued use of the FFR arrangements. But in its judgement in SCR No. 1 of 1984; Re: Morobe Provincial Government v. The Independent State of Papua New Guinea and Michael T. Somare [1984] PNGLR 212, the Supreme Court decided that the departments of the provinces were unconstitutional to the extent that they were constituted by public servants assigned to the provinces.

To understand the implications of the decision in this case, it must be remembered that with the full creation of the departments of the provinces, staff carrying out the transferred activities ceased to hold positions in the Office of Implementation. They moved into positions in the departments of the provinces. As already discussed, this action was seen by the Department of Justice as 'assigning' those public servants to the provincial governments within the meaning of s.49(1) of the Organic Law (Auditor-General, 1981:14). This would seem to be correct, because at that point, staff were not occupying positions in any national department. Rather, they were carrying out provincial activities, the responsibility for which the national government had transferred to the provincial governments. The main reason for the decision in the Morobe Case was that once assigned to a province, public servants came under provincial direction and control (s.47(2) of the Organic Law). If they were at the same time placed in departments created under the Public Service Act, there was an attempt to retain national control over them, an attempt which was inconsistent with the Organic Law.

So by virtue of the combination of the transfer of staff who are carrying out provincial functions away from the Office of Implementation and the decision in the Morobe Case, it is now clear that both the staff and the transferred activities are under the control of the provincial governments. In particular, assigned public servants are part of provincial government structures created by the Organic Law.
Hence the departments of the provinces are separate entities to which funds for transferred activities can legally be allocated. Clearly, then, funding for provincial activities cannot be allocated and controlled in the same way that funding for national departments is dealt with. Rather, as the Organic Law presently stands, there is no basis for provinces to receive funds for the transferred activities except by way of the MUG or perhaps (as discussed later) by means of conditional grants.

Further, it seems that the present arrangements for funding provincial activities through Divisions 271 to 290 are not in any way authorised by the national government's laws governing the management of public finances — in particular, the Public Finances (Management) Act 1986 and the subsidiary laws made under that Act. The major problem is that funds under Divisions 271 to 290 are being allocated to the departments of the provinces, bodies which, prior to 1984, were believed to be legal entities of the same fund as normal departments within the national Public Service, but which the Morobe Case has decided do not have any legal basis, as presently constituted.

The Constitution s.211, requires that all national government moneys are to be 'dealt with and properly accounted for in accordance with law', and that no such moneys are to be expended 'except as provided by this Constitution or by or under an act of the Parliament'. The Public Finances (Management) Act 1986 is the main law dealing with the way the national government's funds are to be expended, dealt with and accounted for. It provides for financial control to be exercised through a chain of delegations of financial powers from the Minister for Finance, to the Secretary for Finance and thence to other departmental heads. Generally, funds are allocated to or through departments, but nothing prevents allocations to other 'public bodies'. However, nothing authorises the allocation of funds to non-existent bodies such as the departments of the provinces, as originally constituted.

Since the Morobe Case, several provincial governments have passed laws establishing their own administrative structures, and for convenience, many of those laws call those structures 'departments' of the provinces. But such 'departments' are not departments within the national government's legal framework. The heads of the provincial departments are not 'departmental heads' within the meaning of the Public Finances (Management) Act. Further, it seems likely that powers, duties and functions under the Public Finances (Management) Act cannot be imposed upon or delegated to officials in the provincial departments except within the scheme of delegation provided for in s.43 of the Organic Law. The scheme provided by s.43 envisages that any powers or functions of the national government under an Act of the Parliament which are to be exercised by any provincial official must be vested in the
provincial official by national law, and exercised by the provincial official 'as provided by a provincial law not inconsistent with any Act of the Parliament'. As there is at present no provision under the Public Finances (Management) Act for the exercise by provincial officials of powers or functions under that Act, there is no legal basis for the allocation and control of funds allocated through Divisions 271 to 290.

Hence it seems likely that these funds are allocated contrary to the express requirements of the Constitution. In practical terms then, all of the moneys allocated and spent through Divisions 271 to 290 — in 1986 almost K44 million — are dealt with through a series of what are arguably illegal transactions.

Curiously, although the reasons for the decision in the Morobe Case were handed down in August 1984, funding arrangements under Divisions 271 to 290 have continued in the 1985, 1986 and 1987 national budgets as if the decision had not been made.

Of course, the judgement in the Morobe Case means that there is no basis for any aspect of the funding arrangements under Divisions 271 to 290. But as some special considerations apply to each of the other categories of funding allocated under those divisions, some comments are now made about each of them.

(b) Salaries of assigned public servants in provinces with FFR

These funds are deducted from the MUG and retained by the national government, which has legal responsibility for the payment of the salaries of assigned public servants (s.49(2) of the Organic Law). They are therefore not part of the grant funds payable to provinces. They are allocated under Divisions 271 to 290 on the basis that allocations under those divisions are in respect of public service departments. So funds are appropriated to meet the personal emoluments of departmental staff in the same way as any other national government public service department. As will be discussed in Part Six of this paper, now that the departments of the provinces have been held to be unconstitutional, funds for salaries should be appropriated in some other way.

(c) Minor Power Houses

As we have already seen, these funds have been allocated to departments of the provinces without provincial consent. This was done on the basis that allocations to those departments were not allocations to the provincial governments. The decision in the Morobe Case makes it clear there is no legal basis for this approach. As a result, the national government will also need to re-examine these funding arrangements.
(d) **New and Ongoing Projects**

As already discussed, there are conflicting rationales underlying the funding for different functions under Divisions 271 to 290. Minor power houses are so funded on the basis that the funds are not being paid to provincial governments, but to separate entities. On the other hand, the basis for funding New and Ongoing Projects is that the funds are conditional grants, paid to provincial governments in respect of particular activities or projects. Conditional grants to provincial governments should, by definition, be grants direct to the governments, and so should be paid to and be accounted for by the provincial governments. They should not be paid to some intermediate legal entity without clear agreement between both levels of government. In any event, the intermediate legal entities to which the grants have been paid (the departments of the provinces) have now been ruled unconstitutional. Hence, new funding arrangements are required.

(e) **Community School Sectoral Programme**

The considerations which apply to New and Ongoing Project funds apply equally to the funding for the Community School Sectoral Programme.

(f) **'Delegated' Health Functions**

On the basis that public servants subject to provincial direction and control are carrying out the delegated health functions, it is arguable they are transferred activities, and so should be funded as such under the MUG. But as already discussed, some provinces do not want that to happen while the present MUG formulation applies.

Alternatively, it may be argued that the provisions of s.65 of the Organic Law should apply and that the funds are really intended to be conditional grants. It seems likely that as s.65 allows conditional grants to be paid 'for any purpose agreed on' that they can be used to fund activities which are carried out by assigned public servants. In other words, if 'agreed', it is possible for transferred activities to be funded by conditional grants rather than the MUG. This argument provides more flexibility than any alternative, and so is more in keeping with the needs of a decentralised system. The funds for the delegated health functions are provided so that public servants under provincial control can carry out activities over which the national government wishes provincial governments to have some degree of control short of total control. In the case of delegated health functions, the provinces agree that they should not have total control. This suggests the funds for those functions should ideally be
allocated as conditional grants. If so, they should be allocated to provinces directly, and accounted for by provinces themselves, rather than allocated and retained within the national budgetary and accounting systems through use of Divisions 271 to 290.

(g) Cash Crop Marketing

Schedule 1. of the Organic Law defines a transferred activity as one which:

'(a) was carried out by the National Government in the fiscal year 1976-1977; and

(b) was carried out by the provincial government at some time after the fiscal year 1976-1977 or is to be carried out in the year of grant'.

Cash crop marketing is clearly such an activity as it was an activity carried out by the Department of Primary Industry in 1976-1977 (Papua New Guinea, 1976:54) and has been subsequently carried out by provincial governments since they became established. There is therefore no legal basis for funds for this activity to be paid in any way other than through the MUG, unless perhaps provinces agree to the funding being paid by way of conditional grant.
PART FIVE: FINANCIAL CONTROL AND NATIONAL-PROVINCIAL RELATIONS

The discussion in Parts Two, Three and Four has indicated the need for changes to be made to the financial arrangements. Such changes are required to meet both practical and legal considerations. But substantial changes to financial arrangements which affect a major part of the national government's funding of provincial activities are unlikely to be entertained lightly. In this regard, it is important to remember that the financial arrangements are only part of the web of national-provincial relations. Hence, before proposals for change can be properly formulated and evaluated, the development of the financial arrangements must be seen in the context of wider movements in those relations. Since about 1980, the main movement has been a growth of national government control over the provinces—the financial arrangements discussed so far have only been a part of that movement. If proposals for changes to the financial arrangements are to have a reasonable likelihood of being implemented, they must to some extent take account of the trend towards central control.

Increasing National Control

Papua New Guinea is not alone in experiencing a shift of power away from decentralised units of government—students of decentralised systems everywhere note the same trend. Mawhood notes that in developed as well as Third World countries, there is a long history of the national government eroding the decentralised structure by 'imposing more controls and starving it of resources' (1983a:3). Reviewing recent literature on decentralisation in Third World countries, Smith notes that '...the trend has been towards greater central control, particularly in financial and personnel matters' (1985:189).

Mawhood sees the history of local government in tropical Africa in terms of a pendulum model: 'the decentralised element swings into favour and out again' (1983a:8). He identifies four main phases of the swing:

- promotion of decentralisation by both late colonial governments and newly independent states;
- a subsequent reaction in favour of central planning and control over resources, even though deconcentrated administration remained in place;
- disenchantment with central planning and a resurgence of commitment to popular participation resulting in experiments with 'mixed' authorities (partly elected, partly appointed) but with power retrained by the centre; and
- recently, a further swing by some central governments to greater autonomy for urban and rural governments (though not as great as in the late colonial period) (ibid.:8).
Although the history of tropical African countries need not necessarily be repeated in Papua New Guinea, it is significant that there is a high level of dissatisfaction with the provincial government system in both the national government bureaucracy and in the National Parliament. Calls for the abolition of the system are frequent, suggesting that the advent of stage two of Mawhood's pendulum may be more than a remote possibility. Whether or not the pendulum will swing that far, there is no shortage of evidence of the growth of central control in Papua New Guinea. In addition to the financial arrangements discussed in this paper, national control has increased through a diverse range of measures including:

- the introduction of the NPEP;
- organisation of assigned public servants into departments of the provinces;\(^{21}\)
- the 1981 introduction of controls on salaries and allowances for provincial assembly members;\(^{22}\)
- the 1983 Constitutional amendments simplifying procedures for suspension of provincial governments and the subsequent suspension (between 1984 and 1987) of seven provincial governments; and
- the abolition (as from 1985) of additional unconditional grants.

The reasons given publicly for the introduction of the individual control measures (financial and otherwise) have generally been sound and sensible, but the fact that so many controls have been adopted is indicative of underlying attitudes prevalent amongst both key national government bureaucrats and politicians. The adoption of almost all of the control measures has been premised on the twin perceptions that the provincial governments are generally performing badly in particular ways, and that only national institutions can properly control or monitor the activities or resources involved. There has been only limited credence given to the alternative view (well supported by experience of North

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21 The departments of the provinces were introduced largely because the Public Services Commission could not conceive that staff assigned to the provinces could be organised under any structure other than a public service department. Even after the 1984 Supreme Court decision in the Morobe Case made it clear that provincial governments could establish structures of their own choice, model provincial legislation prepared for provinces by national government officials still retained the name "department of the province" and most features of normal national public service organisation.

22 Control of provincial assembly members' salaries and allowances was achieved by a 1981 amendment to the national Constitution (s.131) which gave the Parliamentary Salaries Tribunal sole jurisdiction over such matters.
Solomons, Morobe and a few other provinces) that increased resources, technical support and incentives might result in improved performance by provincial governments.

The general belief that national government institutions are the most effective is in part a legacy of the highly centralised pre-independence administrative system. Most national government agencies had great difficulty in adapting their aims and organisations to the decentralised system: the refusal of the Department of Health to obey NEC directives on transfer of staff and functions (described in Part Three), is only one of the more blatant examples of bureaucratic opposition to decentralisation. The centralist tendencies of the bureaucracy have been encouraged by the growing antipathy towards the provincial government system, evident amongst most members of the National Parliament. Examination of the numerous parliamentary debates on provincial government matters since 1978 reveals remarkably few speeches expressing any support for the provincial system. This fact gives credence to the then Prime Minister Somare's 1983 claim that of the 109 Members of Parliament '100 of them want to get rid of provincial government altogether' (Somare 1983:3).

This antipathy has little to do with the admittedly poor performance of many of the provincial governments. It has much more to do with competition for power and resources, because the provincial government system reduced the power of national government Ministers and senior bureaucrats. Works, maintenance and other funding were removed from the influence of backbench members of National Parliament thereby removing their main avenues for claiming credit for delivering services to their constituencies.

In the 1978 to 1982 period, the establishment of four regional governments was often advanced as an alternative to the allegedly wasteful provincial government system. But from 1982, the main advocate of regional governments, Iambakey Okuk, became a reluctant supporter of the provincial system, largely because his return to the National Parliament after his defeat in the 1982 National Elections was largely engineered by the Premier of Eastern Highlands, James Yanepa. Since then, the alternative most often advanced in the Parliament has been removal of the elected provincial governments and a return to deconcentrated public service administration. The proposal would involve breaking up the 19 existing provinces into smaller administrative units, each to be headed by a public servant with powers similar to pre-independence district commissioners. The most vocal proponent of this view in the 1982 to 1987 period was a former klap and (from November 1985 to

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23 For examples of Mr Okuk publicly taking a pro-provincial stance on some issues see - Post-Courier, 27/10/83: p10; Hansard, 7/11/83: p.28/5/3; Hansard, 20/8/84: p.26.
1987) Minister for Justice, Warren Dutton.\(^\text{24}\) He and other key critics believed such changes should be closely examined after the 1987 National Elections. Dutton's proposals, if implemented, would bring into reality the second phase of Mawhood's tropical African pendulum. But there is little reason to believe that a centralised bureaucracy will be any more efficient in administering Papua New Guinea than provincial governments have been. Hence if the provincial governments were to be abolished there is every likelihood that the African experience of dissatisfaction with centralised administration would be repeated and a full cycle of the pendulum swing would result.

The Future of Provincial Government

There are two main factors in the Papua New Guinean situation which suggest that there is some hope that any swing towards central control will stop short of complete abolition of the provincial system. Those two factors are the good record of performance of some provincial governments and the growing intermeshing of national and provincial politics.

The continuing good record of performance of some provincial governments will make abolition of the entire system an extremely difficult proposition. Abolition of those that are performing well would be seen as unjustified and, in North Solomons and East New Britain in particular, a betrayal of hard won political settlements (Conyers 1976; Ballard 1981; Grosart 1982). The threat of secession would once again loom large, and would almost certainly extend beyond North Solomons, and probably beyond even the islands region provinces.\(^\text{25}\) The certainty of such major political upheavals means that abolition of the best performing provincial governments is not a practical possibility. This is acknowledged to be the case by the most realistic senior national government bureaucrats and politicians.

Yet the alternative possibility of abolishing only those that are not performing well raises equally difficult problems. First, assuming that the performance of each provincial government lies somewhere on a continuum from very good to very bad, the identification of the point on the continuum below which abolition would result would inevitably cause great political turmoil. Second, for only a few provinces such as North Solomons and East New Britain to retain provincial government would be totally

\(^{24}\) For parliamentary speeches by Mr Dutton outlining his proposals for the provincial government system, see - Hansard, 9/8/83: pp.9/6/4-10/6/2; Hansard, 22/3/85: p.35.

\(^{25}\) The provinces known as the 'islands region' provinces are North Solomons, East New Britain, West New Britain, New Ireland and Manus.
unacceptable to both national and provincial leaders in many provinces that would lose provincial government status. After all, the fear of appearing to give favoured treatment to, or of making a special case of, Bougainville was a major difficulty for the then Somare government during the pre-independence debates on provincial government (Ballard 1981:109). It was also an important factor in the decision to extend the provincial system that Bougainville had won for itself in the Bougainville Agreement (1976) to all provinces through the Organic Law, and through the 1977 NEC decision to extend uniform powers, functions and resources to all provincial governments irrespective of capacity. The same political pressures exist in the late 1980s.

The intermeshing of politics at the national and provincial levels has been expanding steadily, but has generally been little understood. The emasculation of Iambakei Okuk as the chief critic of provincial government is the most striking individual example of the process. But there are numerous other examples:

- the extension of national political party activities into elections for and operation of all provincial assemblies;
- the movement both of major provincial political figures into the National Parliament and of defeated members of Parliament into provincial assemblies;\(^26\)
- the action of some provincial governments in backing candidates from a variety of parties as 'provincial' candidates in national elections;\(^27\) and
- the success of the islands region premiers in 1983 and 1984 in cooperating with national government MPs from the region to oppose national government proposals to make the Organic Law an ordinary law and to have a referendum on the future of the provincial government system (Regan 1985:57; Regan 1986c:39 and 51-52).

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\(^{26}\) In the 1982 National Elections, former East New Britain premier, Mr Ereman ToBaining was elected to the Parliament. In the 1987 National Elections, the former premiers of Morobe and West New Britain (Mr Utula Samana and Mr Bernard Vogae) were elected. A number of prominent provincial figures stood and lost. Defeated members of the National Parliament who have subsequently become provincial assembly members include Mr T. Korea (Gulf), Mr A. Bilas (Madang) and Mr O. Tammar (East New Britain).

\(^{27}\) The East New Britain Provincial Government premier (Mr R. ToVue) and Finance Minister (Mr S. Brown) provided unofficial provincial government support for particular candidates from different parties in both the 1982 and 1987 National Elections. (Regan 1986c: 38). The interim provincial government in Southern Highlands Province took similar action in 1977.
One likely result of the growth of these and other linkages, formal and informal, is that abolition of the provincial system would be very difficult. In the face of a serious abolition proposal, supporters of the provincial government system would be able to mobilise support from many and perhaps unexpected sources.

More likely than abolition is the development of a more differentiated system under which greater powers and autonomy would be available to provincial governments that perform well, while poorly managed provincial governments would face greater controls. Such an approach was recommended by the 1984 Specialist Committee Report (Department of Provincial Affairs 1984, Vol.1:p.5, Recommendation 1). That recommendation has been accepted by the national government (Minister for Finance and Planning 1986:2). The delegation, in early 1986, of significant land powers to two provincial governments (East Sepik and East New Britain) on a trial basis may be a precedent that will be applied more generally. Prior to the 1986 delegation of land functions, virtually all aspects of the transfer of powers, functions and resources to provincial governments have been handled on a uniform basis, with little or no regard for the varying capabilities of provinces. One consequence has been a growing frustration on the part of the more capable provincial governments at the refusal of the national government to transfer powers and functions that the provinces believe they could handle more effectively than the national government (Department of Provincial Affairs 1984, Vol.2:p.16). A differential approach to the devolution of powers and functions should reduce such

28 The full text of the recommendation is as follows:

'The devolution of powers and functions from the national government to provincial governments should no longer be uniform. In future, powers and functions should be devolved on the basis of individual provincial governments' capacities and wishes, as is enabled by Section 114(3) of the Organic Law on Provincial Government' (Department of Provincial Affairs 1984, Vol.1: p.5, Recommendation 1).

In discussing this recommendation, the Report noted that the existing uniform approach to devolution of powers 'forced functions on provincial governments not ready (and not always willing) to take them; on the other hand it held back provincial governments that had the capacity and the desire to take on more' (ibid., Vol.2: 8). Elsewhere, the Report notes that 'concern about problems arising in provinces that cannot manage their existing powers has resulted in great reluctance at national level to transfer any additional powers to any provincial governments, irrespective of their relative capacities to manage. This has led to considerable frustration in some provinces' (ibid.:16).