



Australian Government
AusAID

Core Group Recommendations Report for a White Paper on Australia's aid program

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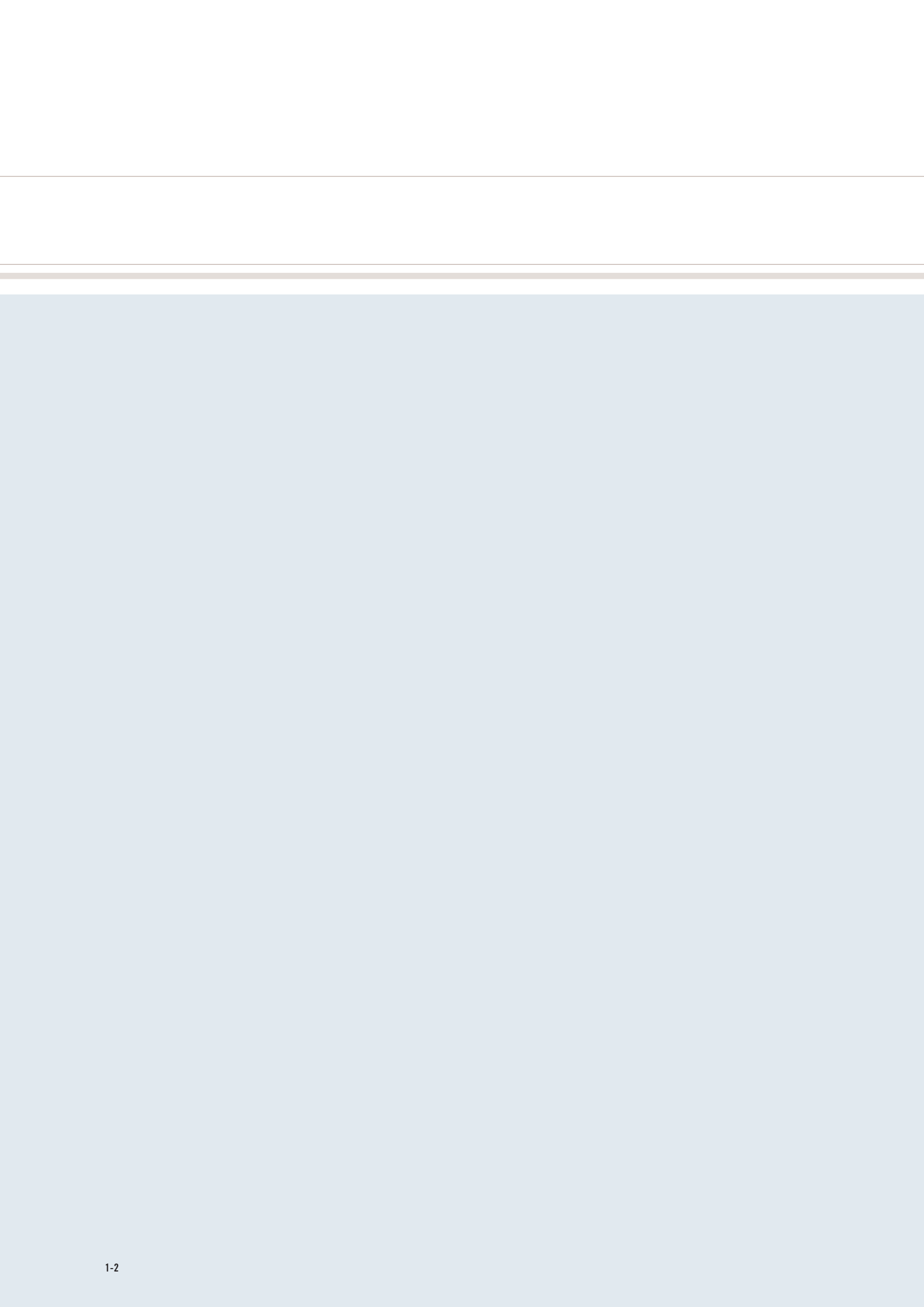
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Guide for the Core Group



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Introduction

In his speech to Parliament on 10 March 2005 on tabling the Thirteenth Annual Parliamentary Statement, *Australian Aid: An Integrated Approach*, the Minister for Foreign Affairs announced that he would present in a year's time a White Paper on Australia's Aid Program.

The overall objective of the White Paper is to outline a medium-term strategic blueprint for the Australian aid program in the Asia-Pacific region.

The purpose of this paper is to provide a framework for analysis and discussion for the Report of the Core Group to the Minister for Foreign Affairs on the White Paper on Australian Aid. It outlines:

- > the current policy framework and recent developments in the Australian aid program;
- > trends in international development thinking;
- > key considerations for Australia's medium term aid engagement with our key partners in the Asia Pacific, and on HIV/AIDS; and
- > issues relating to the participation of the Australian community in the aid program over the medium term.

Part 1: Context

AID POLICY FRAMEWORK AND DEVELOPMENTS

Global events and those closer to home have shaped significantly Australia's engagement with the region and that of the aid program. The Asian financial crisis; terrorism and threats to regional security; HIV/AIDS; East Timor; conflict, instability and deteriorating governance in Solomon Islands; and more recently the Indian Ocean tsunami and earthquakes in Indonesia have all required the aid program to adapt to the changing demands of the region.

At the same time, increasing knowledge on what makes countries successful has informed and shaped Australia's aid focus. This includes the centrality of broad-based economic growth and trade, the fundamental importance of sound institutions of governance and stability, and the need for effective investments in people.

Significantly, the aid program has sought to deliver practical responses, often in partnership with other arms of government and the donor community, that focus on outcomes that offer the greatest chances of success in particular country and regional circumstances.

The main features of Australia's evolving aid engagement over recent years include:

- > **a sharper focus, both financially and intellectually, on our immediate region and on governance:** the proportion of aid to **PNG, the Pacific and Indonesia** – our three largest Overseas Development Assistance partners – has increased from 45 per cent to 65 per cent between 1999–00 and 2004–05, and will increase further with the additional \$1 billion program to Indonesia. Support to strengthen the core institutions of the state has increased from \$192 million five years ago to an estimated \$674 million in the 2006–07 budget.
- > **a more pro-active and integrated Australian Government approach:** there is significantly increased engagement by key Australian Government agencies grappling with the region's governance challenges and assisting countries to maximise the benefits of globalisation and regional integration. This has been particularly highlighted by a more hands-on role to address governance weaknesses in the Pacific that do not lend themselves to traditional solutions e.g. Solomon Islands Regional Assistance Mission (RAMSI). Australia's joined-up approach has also been evident in the government to government partnerships in Indonesia, ASEAN cooperation, trade policy, responses to terrorism, people trafficking, corruption, and peace building, for example in Bougainville. More recently this has

BOX: AID POLICY FRAMEWORK

Over the past eight years, two policy statements have provided the basis for Australia's current aid policy framework. In 1997 the Government outlined its aid policy in *Better Aid for a Better Future*. This was subsequently updated in the Foreign Minister's Eleventh Annual Parliamentary Statement in 2002, *Australian Aid: Investing in Growth, Stability and Prosperity*. These statements in turn need to be read in the context of Australia's broader interests as articulated in *Advancing the National Interest: Australia's Foreign and Trade Policy White Paper* (2003)

The objective for the aid program that was set in the 1997 policy and reaffirmed subsequently is:

"To advance Australia's national interest by assisting developing countries reduce poverty and achieve sustainable development"

The 1997 and 2002 policy statements reaffirmed the focus of Australia's aid **on the Asia-Pacific** region, particularly our immediate neighbours. Australia is one of very few OECD donors located in a region comprising developing countries, many of which are fragile states. With deep trade, defence, economic and diplomatic relationships with countries in the region, the strategic dimensions of aid are clearly evident. The geographic focus of Australia's aid program was supported by the recent DAC review of the program.

The 2002 policy statement outlined the program's **five guiding themes** (i.e. governance; globalization; stability and service delivery; regional security; and natural resource management) that link activities with the program's Poverty Reduction Framework (2001).

Separate policy statements and strategies have also been released on specific issues. These include: peace and conflict, HIV/AIDS, governance, water, counter-terrorism, health and education. Country and regional strategies for key parts of the program translate policy priorities to individual country and regional circumstances and priorities, and guide program interventions.

The most recent Ministerial Statement to Parliament *Australian Aid: An Integrated Approach* (2005) updated priorities for the program. These centre on:

- > a closer partnership with **Indonesia**
- > long term and innovative approaches to our engagement with **fragile states**
- > initiatives to stimulate broad-based economic **growth**
- > strengthening **political governance** and tackling **corruption**
- > addressing **transnational threats**, particularly HIV/AIDS
- > contributing to **stability and security**.

included responses to humanitarian emergencies such as the tsunami and earthquakes in Indonesia.

> **changes in managing the aid program:**

AusAID has strengthened its policy, analytical and implementation capabilities, and its responsiveness. This has been underpinned by a strategic planning process which commenced in 2001. A stronger policy framework has been developed in areas such as governance, water, peace and conflict, humanitarian action and HIV/AIDS – the latter reinforced by a \$600 million initiative and the appointment of a Special Representative to oversee policy implementation.

New methods of delivery are being employed such as sector wide programs, sub-national initiatives and technical assistance facilities. To improve effectiveness, Australia has further untied its aid. Greater capacity has been developed in the field to shift program management in-country and to enable Posts to engage more substantively on policy dialogue and contribute to the policy and analytical agenda – the proportion of AusAID staff in the field has doubled over the past eight years.

The Peer Review of Australia by the Development Assistance Committee (DAC) of the OECD in December 2004 concluded "*Australia has made significant advances since the last review in 1999 in*

adapting to the new challenges faced by the Asia Pacific region... The OECD DAC recognises Australia's leading role in its neighbouring region, particularly in HIV/AIDS, approaches to fragile states and peace-building and conflict resolution".

INTERNATIONAL DEVELOPMENT THINKING

There is increasing awareness that the peace, prosperity and security of all countries are increasingly intertwined. The threat that poverty poses to these interests is reflected in the focus on developing country issues in the Doha Round of Trade Negotiations, and initiatives such as the Millennium Development Goals (MDGs), debt relief and calls for greater aid. The UN Summit in September 2005 will review progress against the Millennium Declaration including the MDGs, which will prompt further international discussion on efforts to reduce poverty and focus public debate.

Three issues in the current international debate are of particular relevance to Australia.

ROLE OF GROWTH, TRADE AND INSTITUTIONS

There is a strong international consensus that broad based economic growth is central to reducing poverty. In East Asia, progress in reducing poverty is strongly correlated with its impressive growth performance compared to that of sub-Saharan Africa. Countries that have opened themselves up to trade and investment have grown much faster than those that have not.

More recent research has pointed to the fundamental role that institutions and governance play in generating and distributing the benefits of growth. Many countries have experienced growth without making substantial reductions in poverty or improvements in living standards (e.g. Pakistan, Zambia). It concludes that institutions that provide dependable property rights, manage conflict, maintain law and order and align economic incentives with social benefits are an important foundation for long term growth.

As the engine for growth, donors have concentrated on improving the environment for private sector

development. This has primarily been through helping to establish economic and social stability, supporting an educated and healthy workforce, financing infrastructure and facilitating trade. More recent research has focused on the costs of doing business in developing countries, finding that red tape is a major obstacle to growth, with heavy regulation and weak property rights dampening growth and excluding the poor from doing business.

SECURITY AND FRAGILE STATES

The central message of the UN High Level Panel on Threats, Challenges and Change is that security and development are linked, and that progress is required on both. Aid is increasingly seen as an important instrument to help prevent conflict and build peace, mitigate the impact of conflict and assist in post-conflict recovery. In conflict and conflict prone environments, the development and security communities are increasingly required to work together.

The economic, social and security implications of fragile states, and their spillover impact on neighbouring countries, have prompted significant international attention. Recent research has concluded that fragile states that are not assisted have little prospect of overcoming their problems and are likely to experience ongoing fragility and stagnation for generations. The economic cost of fragility is considerable: the long-term cost of a typical fragile state is estimated to be in the order of \$100 billion in foregone GDP, excluding important non-economic spillover effects such as violence, crime, disease, refugees or the security consequences of allowing fragile states to fail.

There is an emerging international consensus that engagement must address the development, economic, security, and political aspects of fragility in an integrated way. Engagement strategies must be country specific and aid has a particular role to play in fragile states to strengthen governance, build sustainable government institutions, exploit opportunities to stimulate growth, and maintain the delivery of services to minimise the impact of system failures on the poor.

AID EFFECTIVENESS

International discussion on aid effectiveness has centred on three core issues:

Aid Instruments: Many donors have significantly increased both their aid volume and their use of new aid instruments. This has involved the use of programmatic assistance (such as sector wide approaches), support for new financing facilities such as the Global Fund to Fight AIDS, Tuberculosis and Malaria and the US Millennium Challenge Account, and the provision of budget support for developing countries. These have been introduced as a result of the frustration with the effectiveness of time bound project approaches which have often been seen as too rigid, slow to implement and as creating parallel systems that do not lend themselves to sustainable outcomes. Programmatic assistance and budget support have usually centred around support for countries' own Poverty Reduction Strategy Papers.

Harmonisation and Alignment: Donors have moved to strengthen the harmonisation of their assistance and processes with other donors to reduce transaction and coordination costs for partner countries. They have also increasingly aligned assistance to partner government budget processes and systems to enhance ownership and sustainability. The Rome and Paris Declarations underlined the international donor community's commitment to the principles of harmonisation and alignment. That commitment aside, pragmatic considerations such as accountability and efficiency have impinged on the capacity of donors to fully embrace and implement alignment.

Value for Money: An evolving debate relates to value for money of aid interventions. Traditionally this has been seen in the context of untying of a donor's assistance from their own national or restricted suppliers. In 2001 Australia joined a consensus of OECD/DAC members signing up to the 2001 DAC Recommendation on Untying Official Overseas Development Assistance to Least Developed Countries (LDCs). Australia has taken significant steps in untying its technical cooperation program, including: abolishing nationality restrictions on AusAID's overseas implementation projects,

in-principle policy of untying bilateral technical cooperation to LDCs, amendment of eligibility criteria, and untying of tenders for construction work. The debate on where to concentrate value for money considerations over the coming period is moving away from just untying which is becoming less relevant with the changes in aid approaches and the internationalisation of the "aid" industry.

On aid effectiveness issues, the DAC review of Australia's aid program found that:

"... AusAID is changing its approach to aid delivery. The DAC recognises AusAID's movement towards harmonisation and alignment, including practical examples of delegated co-operation and joint strategies, and encourages the move toward a more programmatic approach. The role and significant share of external technical assistance as well as AusAID's high reliance on external contractors should be carefully analysed against aid effectiveness principles, ownership and capacity building. Aid effectiveness would be enhanced by further untying."

Australia's aid delivery has changed with the emergence of new approaches. AusAID agrees with many of the shortcomings of project approaches, particularly sustainability and host country ownership issues. New program approaches have been introduced and there is a greater use of host country systems. Programmatic approaches have been adopted in the health, education and justice sectors of PNG and Australia has participated in harmonisation efforts in Cambodia and to some extent with New Zealand in the Pacific. Australia's approach has tended to be more evidence based and hence has been tinged with a pragmatic and realistic assessment of outcomes. For this reason, Australia has been more cautious than some other donors on moves towards budget support. Aid effectiveness issues should also focus on what bilateral donors do best which often has as much to do with flexibility, responsiveness and ideas as with money.

Part 2: Key Considerations for the White paper

OVERVIEW

The challenges to development will continue to grow, particularly in parts of south-east Asia and the Pacific. Levels of poverty exist despite the region's unprecedented success in reducing poverty over the last twenty years. HIV/AIDS and emerging pandemics, threats to stability and security, pressures on natural resources and the environment, and continuing weak and failing governance and capacity across much of the region threaten development gains and undermine prospects for reducing poverty.

At the same time, new opportunities are emerging. The growing economic and political influence of China and India in the region is set to accelerate over the next decade. New regional cooperation and integration, increasing trade openness and the benefits of globalisation more generally, offer avenues to build on Asia's remarkable growth.

Australia has deep economic, political, and security interests in the region. The peace and prosperity of Australia is closely aligned to that of countries in the Asia-Pacific, particularly in our immediate region.

Australia has forged a growing presence and influence in the region based on a position of economic strength and an understanding of the importance of security, governance and globalisation for regional peace, prosperity and poverty reduction. Efforts to strengthen relationships have been most recently evident through the Joint Declaration on Comprehensive Partnership between Australia and

the Republic of Indonesia and the new \$1 billion aid program, free trade agreements with countries such as Thailand and Singapore and underway with China, and nine memoranda of understanding between Australia and countries in our region, including the Philippines, on counter-terrorism.

The aid program is an integral part of Australia's strengthened engagement.

With the objective and geographic focus of the aid program reaffirmed in *Australian Aid: An Integrated Approach*, the key question confronting the White Paper is: Within the broader Australian Government engagement, how should the strategic direction of the aid program evolve from the current framework over the coming years?

In answering that question the Core Group's Report to the Minister, and the country and thematic analyses should:

- > reflect an understanding of the development prospects and challenges facing the Asia-Pacific over the next five to ten years,
- > build on the platform already established by the aid program including lessons learnt, and
- > develop a clear understanding of where the Australian aid program can make a discernable difference in the region which spans the largest and smallest countries in the world with very different development histories and prospects.

GENERIC QUESTIONS FOR CORE GROUP REPORT AND ANALYSES

Regional Development Challenges

- > What are the trends over the next five to ten years that will impact, both positively and negatively, on growth, stability and poverty reduction in the Asia Pacific?

Implications and Directions for Australia's Aid Program

- > In light of these trends, and building on the platform established by the existing program and broader Australia Government engagement, where can Australian aid add value over the medium term, particularly with reference to:
 - > **Accelerating and sustaining growth**; focusing on the drivers for growth including property rights and surety of returns, regulatory constraints to private sector development; and market access.
 - > **Boosting rural productivity**; particularly agriculture and role of research, small to medium scale enterprise development, building markets and economic and social infrastructure.
 - > **Strengthening governance**; evolving to focus on matching national aspirations and structures with sound functioning institutions, leadership and decision making; with consideration given to affordability issues.
 - > **Combatting corruption**; building on both the supply of anti-corruption institutions and processes with the generation of demand.
 - > Building human capacity; particularly human resource development, focusing on education, health and demographic change and impacts on employment.
 - > **Addressing pandemics**; most pressingly HIV/AIDS and promoting regional leadership, but also emerging pandemics such as SARS and Avian Bird Flu and underlying health and surveillance capacity.

- > **Promoting environmental sustainability**; as it supports continuing growth particularly natural resource management and transboundary issues such as water.
- > **Enhancing stability**; through building state legitimacy, peace-building and conflict and disaster prevention, responses and transitioning to development, and helping to manage terrorist and criminal threats.
- > Where should the aid program be investing more and what should it not do?

Implementation

- > How should Australia's aid instruments, approaches and partnerships evolve to deliver effectively on its medium term strategic outlook?
 - > What has been learnt about what works, and how can these be scaled up, including:
 - on approaches to fragile states; and
 - issues of ownership and affordability.
 - > How can Australia's aid be better harmonized and aligned with national development efforts and other donors?
 - > What opportunities are there to adopt regional approaches to address common challenges and sub-national approaches for specific challenges?
 - > Are existing aid delivery mechanisms adequate for the medium term challenges and should Australia be adopting more programmatic approaches and, if so, where and how?
 - > Who will be the program's key strategic partners over the medium term and how should the nature of these partnerships evolve?
 - > How can institutional, academic, people to people and community links facilitate and enhance the aid program?

The White Paper will need to focus on specific issues confronting the aid program in Papua New Guinea and the Pacific, Indonesia and the rest of Asia while also paying particular attention to HIV/AIDS and the role of the Australian community.

PAPUA NEW GUINEA AND THE PACIFIC

The development performance of PNG and the Pacific region has been mixed. Successes have occurred alongside failures and while social indicators such as life expectancy rates have risen significantly since the mid 1970s, particularly in comparison with sub-Saharan Africa, economic performance has not been as impressive. Generally, the Polynesian countries have fared better than their Melanesian and Micronesian counterparts whose per capita growth rates are undermined by poor growth and rapidly growing populations. Weak governance and institutional capacity and chronic underperformance of key agencies of state is common across the region. Instability has also affected a number of countries such as the Solomon Islands.

Australia is a major player in PNG and the Pacific region and, in many cases, the largest donor and trading partner. Australia as such wields significant influence and has deep historical ties with the region. The impact of Australia's aid is therefore significant and has an impact at the macro level. Australia's most significant partners in this region are the World Bank, Asian Development Bank, Japan, the EU, New Zealand, France and China.

PAPUA NEW GUINEA

PNG continues to confront difficult economic prospects despite some recent economic relief from strong commodity prices. There is widespread breakdown in service delivery and the economic and social impact of the HIV/AIDS crisis will intensify in the next three to five years. There are cases of instability (particularly in the Highlands) and the population will double in the next 20 years. This places a premium on generating broad based growth and employment, but PNG has struggled to achieve this outside the resource sector.

PNG has been the largest recipient of Australian aid since its independence in 1975 and is likely to continue to be so for the foreseeable future. PNG has some of the most direct impacts on Australia's national interests. Australia has had a thirty year aid engagement with PNG but the nature of this

engagement has changed significantly over the last decade. Prompted by concerns over accountability, untied budget support was gradually phased out in the 1990s and finally ceased in 2000. In its place, a major scaling up of jointly programmed assistance has been developed. This initially centred on five sectors, health, education, rural development, infrastructure and law and order.

As part of Australia's ongoing bilateral aid relationship, a new long term vision and strategy for engagement with PNG is being developed. This will be consistent with Australia's approach for engaging with fragile states. The strategy will focus on fostering **sustainable economic growth**, particularly in rural areas; building stronger **political governance**; developing **institutional capacity** at all levels of government, a twenty to thirty year undertaking, particularly to arrest the decline of standards in public expenditure management; and addressing **HIV/AIDS**. It will look at ways to use the aid program as an incentive to support reform.

A country strategy to be drafted this year will articulate such a long-term vision. The strategy will build on a review of Australia's aid to PNG undertaken in 2004.

In addressing the Generic Questions posed on page 1-10, particular issues to be considered by the analytical teams and Core Group include:

- > lessons to be drawn from Australia's approach to PNG in the context of approaches to fragile states
- > approaches in conflict prone areas such as Bougainville and Southern Highlands
- > state building aspects of Australia's aid engagement
- > supporting service delivery at all levels and issues relating to capacity building and inter-governmental financing
- > the role of non state players in PNG's development
- > strengthening the performance framework and incentive basis for Australia's aid engagement
- > division of responsibility between Australia and PNG's other main development partners, particularly the World Bank and ADB in the medium term

PACIFIC

The development prospects for the Pacific are mixed. Most countries in the region are vulnerable to developmental decline due to their small size, lack of economic diversity, remoteness from major trade and commercial sectors, and weak governance frameworks. Economic gains have been weak, volatile and unequally distributed and instability has hampered growth.

Poverty in the Pacific is linked to poor governance, especially weak leadership and corruption. In many parts of the region, decision makers in positions of trust and authority, on occasion exercise their power in ways contrary to the interests of their nation and constituents. A number of factors and competing incentives contribute to this: sectional interests, insufficient links between formal institutions and informal power structures, tribal allegiances and basic corruption for personal gain are all factors that cause political governance to fail, with the actions of a few thereby undermining the prosperity of entire nations.

Countries, particularly in Melanesia, face high fertility rates and youth bulges. Vanuatu for instance has 45 per cent of its population under 15 years old, and like other countries in Melanesia, faces serious challenges in creating employment and providing services for its youth. Tonga and Samoa have been able to relieve population pressures through access to emigration, most notably to New Zealand and the United States which, through remittances, has also proven to be a dependable source of income.

In addition to the governance and capacity challenges faced by many Pacific nations, small populations scattered over vast distances make social and economic development and the provision of services particularly difficult. Regional approaches to development based on the pooling of resources between governments are emerging as a means for countries to achieve their economic goals.

BOX: PACIFIC 2020

A new study, *Pacific 2020*, will focus on long-term growth options for the developing economies of the Pacific. The study will be a follow-up to the 1994 study of development prospects in the Pacific, *Pacific 2010*, and will be launched at a regional conference on growth prospects for the Pacific, PNG and East Timor to be held early in 2006.

Pacific 2020 will focus on the issues most critical to achieving sustainable growth and development in the region, and highlight the key actions needed in the short to medium term to give countries of the region the best chance of realising their potential by 2020. Issues will include: political governance: key productive sectors such as agriculture, fisheries and tourism; land and property rights issues; and HIV/AIDS and demographic issues, including high population growth and the youth bulge.

The *Pacific 2020* exercise will be considering the long term growth prospects for the region from a number of different perspectives. The White Paper will be focusing on the role of Australian aid in promoting growth and development in the region. Hence the two exercises will be mutually reinforcing and closely coordinated.

At the 2004 Pacific Islands Forum, leaders agreed to the development of a Pacific Plan for Strengthening Regional Cooperation and Integration. The Plan aims to identify areas where individual island nations can benefit most from sharing their limited resources and aligning policies to provide public goods such as law and order, basic infrastructure and regulatory systems. With support from Australia, senior officials from Pacific nations are drafting the Plan for presentation to leaders at their annual forum to be held in Papua New Guinea later this year. This initiative will build upon other regional initiatives including regional transport reforms, the Pacific Regional Policing Initiative and the Pacific Governance Support Program.

A new Pacific Regional Aid Strategy 2004–09 provides the framework for Australia's long term

development goals in the Pacific. The framework focuses on four themes: stronger broad based growth; more effective accountable and democratic government; improved law and justice and security; and enhanced service delivery, including effective fiscal management. Under the strategy, Australia will channel an increased proportion of assistance to Melanesia, and focus more closely on capacity building and conflict prevention.

Australia is applying a more pro-active and hands on role to its aid program in the Pacific. The Regional Assistance Mission in the Solomon Islands reflects this more interventionist role to address law and order and economic governance failings that threatened to lead to state collapse with potential spillover effects to neighbouring countries. While not a model that would necessarily be applied elsewhere it does signal a preparedness to explore with partner countries non traditional solutions to deteriorating governance and weak capacity in the region.

Australia will be placing a greater emphasis on regional approaches in aid programming

and play a lead role in building cooperative frameworks with other donors, including the IFIs, and regional organizations.

In addressing the Generic Questions posed on page 1-10, particular issues to be considered by the analytical team and Core Group include:

- > determining the extent of the decline in the Pacific and how much of this is due to endogenous and exogenous factors
- > opportunities to influence political governance in the region
- > lessons learnt, both positive and negative, on donor engagement in the Pacific
- > planning timeframes to be used to bring about change in the Pacific, and performance frameworks and intermediate solutions which acknowledge the likely pace of change
- > realistic assessments of what can be achieved in small states
- > consideration of innovative solutions to states with limited economic prospects
- > the role of non state players in the Pacific's development

- > balance between bilateral, regional and multilateral approaches
- > constraints to adopting more programmatic approaches and for accelerating harmonisation and alignment of aid to the region
- > long term capacity development, including through the use of transition strategies, in situations where Australia is taking a more interventionist approach

INDONESIA AND ASIA

Unlike the Pacific, Australia's aid as a contribution to GDP to most countries in the Asia region is modest. Yet Australia's interests in the region are very strong. Accordingly, Australia's challenge is to identify those areas where it can make a strategic contribution to economic and social development in individual countries and the region as a whole. A stable and prosperous Asia is fundamental to Australia's own economic and security interest as well as its humanitarian concerns.

A key question therefore is how Australian aid can make a discernable impact in different circumstances. Thus issues of focus carry significant strategic importance, as does the way aid is used to strengthen partnerships for greater leverage.

INDONESIA

Poverty levels in Indonesia are declining and are likely to continue to decline notwithstanding the devastating impacts of the December 2004 tsunami which left 120,000 dead, 300,000 missing and 500,000 Internally Displaced Persons. During 2004 there was evidence of growing confidence in the Indonesian economy. The economy grew by approximately 5 per cent and inflation remained largely under control. Successful democratic parliamentary and presidential elections were held in 2004 – important steps toward the consolidation of Indonesia's democratic transition. The new Yudhoyono Government has prepared a National Medium-Term Development Plan which seeks to build on these developments through three objectives: creating a peaceful and secure Indonesia; creating a fair and democratic Indonesia; and

improving public welfare. Moves to reduce fuel subsidies and to tackle corruption are strong signals of the government's willingness to move on key issues of economic and legal reform.

However, significant challenges remain in Indonesia. According to the World Bank growth has been unequally distributed and making major inroads into poverty is still very difficult particularly in rural areas. The poor lack access to basic health and education services, and unemployment in the formal economy remains a major concern, with the open unemployment rate reaching 9.3 per cent in 2004. Investment in human capital and infrastructure from domestic, foreign, government and private sources, continues to be inadequate. Conflict still affects several areas of the country and, despite effective action by the Indonesian police, the threat of terrorism remains. Corruption is an extremely serious problem, weakening the effectiveness of government and the judiciary and inhibiting investment. The legal infrastructure is weak and there is little confidence in its ability to serve the needs of government, business and citizens.

In addition, in 2001 the Indonesian Government commenced a daunting decentralisation process involving fundamental devolution of functions from the central to the district level and an accompanying radical restructuring of inter-governmental fiscal relations. The potential benefits of decentralisation are significant, in terms of bringing government services closer to the people, making elected governments more responsible to the people they represent, raising levels of public accountability and improving basic service delivery, such as health and education.

But so are the risks. While there are increasing signs of district governments taking responsibility for essential service delivery, planning, management and budgetary frameworks need strengthening. Decentralisation presents opportunities for donors to contribute to reform and improved governance and service provision in Indonesia.

Finally, Indonesia's progress to a vibrant democracy is still in the early stages. There are high expectations of the Yudhoyono Government from foreign and domestic stakeholders – delivering on these will be

extremely challenging but crucial if a democratic system is to be entrenched in Indonesia.

Australia is a long-standing and growing donor to Indonesia with particularly close and important bilateral ties. AusAID's country strategy for Indonesia, released in 2003, targets four inter-related objectives:

- > **Improve economic management** through support to accelerate structural reform including assistance for revenue enhancement, financial sector restructuring and supervision, and debt management.
- > **Support the transition to democracy** by strengthening democratic institutions and practices, through assistance for legal and judicial reform, the institutions of human rights and public accountability, electoral and parliamentary processes and institutions, and civil society.
- > **Enhance security and stability** through support for law enforcement and counter-terrorism capacity building, conflict and disaster prevention and humanitarian assistance for vulnerable groups.
- > **Increase the accessibility and quality of basic social services** through policy engagement at the national level and support for planning and implementation at the district level, and support for community-based approaches.

The impact of the December 2004 Indian Ocean tsunami was greatest in Indonesia. While Indonesia welcomed the massive outpouring of international assistance following the tsunami, the response also presented Indonesian authorities with serious logistical and coordination challenges. Donors have recognised these challenges and are committed to working together with the government to develop a framework for recovery and reconstruction.

Demonstrating Australia's long term commitment to Indonesia, and concern for the impacts of the December 2004 tsunami, the Australia Government announced the establishment of a \$1 billion, five-year Australia-Indonesia Partnership for Reconstruction and Development (AIPRD). The objective of the AIPRD is to support Indonesia's reconstruction and development efforts, both in and beyond tsunami-affected areas, through sustained cooperation focused on the Indonesian Government's programs

of reform with national priorities set by the Indonesian Government, with an emphasis on economic and social development.

The AIPRD is governed by a Joint Commission, overseen by the Prime Minister of Australia and the President of Indonesia. The partnership will be implemented according to agreed guiding principles which, inter alia, emphasise the joint nature of the AIPRD, the need to take account of Indonesia's needs and development efforts, Australia's comparative advantage and the importance of coordinating activities with international development partners.

Under the AIPRD, \$500 million will be provided through a grant assistance program and \$500 million will be provided through a concessional loan program. The \$1 billion commitment is additional to Australia's existing annual \$160 million aid program to Indonesia.

In addressing the Generic Questions posed on page 1-10, particular issues to be considered by the analytical team and Core Group include:

- > the longer-term geographic focus of Australia's expanded assistance, as between areas of greater relative poverty and vulnerability (e.g. in Eastern Indonesia) and other areas elsewhere where absolute poverty levels are higher
- > areas where Australia can help to play a leadership role as it is already doing in basic education and other niche areas of economic and financial management – options may include e.g. HIV/AIDS
- > areas where the development of long-term linkages between Australian institutions and Indonesian counterparts may support Indonesia's democratic transition and its management of key economic and legal reform processes
- > how Australia can most effectively work with other development partners, including in the alignment and harmonisation of major donor effort

ASIA

The significance of Asia to the world is set to increase. The world economy will be affected by Asia's economic trends and ever increasing population. The economic prospects of East and

South Asia reflect a large, diverse region. Economic disparity is evident both across the region and within individual countries. The Asian economy encompasses top performers such as China, India and Vietnam and the fragile states of Burma, Laos and Cambodia. The region is returning to strong economic growth, having recovered from the 1997 financial crisis and other shocks such as the SARS (2003) and the Avian Influenza outbreak (2004).

Asia's development challenges remain extensive. Despite impressive reductions in poverty over the last twenty years, there are still 700 million people living on less than US\$1 a day and 1.9 billion living on less than \$US2 a day. Widening growth gaps among Asian economies, transborder challenges including regional health and security issues, and weak governance in parts of the region continue to threaten stability, security and prosperity. As well as Burma, Cambodia, Laos and Nepal, the performance of the Philippines economy is of particular concern given its population and in security terms. Demographic trends, from ageing populations in parts of Asia through to countries experiencing youth bulges such as East Timor, fragile states and social and political factors all present specific challenges

Asia's continued and sustained rapid development is vital to Australia. The extensive opportunities and challenges facing Asia to reduce poverty further, and Australia's national interest in the stability and prosperity of the region, underpin much of Australia's aid in the region. Australia's aid program to East Asia is integral to Australian whole of government efforts to address transborder and regional challenges.

Australia's aid to East Asia (estimated at \$333 million in the 2004-05 budget excluding Indonesia) comprises individual bilateral programs jointly programmed and determined with each country and regional programs. The largest of these is Vietnam at \$74 million, followed by the Philippines (\$62m), China (\$49m), Cambodia (\$41m) and East Timor (\$40m). Each of these programs is designed to achieve country strategy objectives which usually emphasise poverty reduction through growth and improved governance.

There has been an increase in support for regional programs in recent years. This is supported by two objectives:

- > strengthened capacities of key regional institutions to enhance economic integration and trade liberalisation; and
- > improving regional responses to transboundary development challenges.

Australia's aid engagement with East Asia has expanded to address a wide range of transborder issues. For instance, support of regional economic integration and trade liberalisation through ASEAN and APEC, as well as counter-terrorism, corruption and money laundering, HIV/AIDS, human and animal disease outbreaks, people trafficking and drug control.

In addition, Australia has some niche engagements in South Asia, with a particular focus on Bangladesh, Sri Lanka, and peace and conflict.

In addressing the Generic Questions posed on page 1-10, particular issues to be considered by the analytical team and Core Group include:

- > identifying the main drivers of growth and poverty reduction and partners for reform (both nationally and on a regional basis) and how the aid program can best engage with and support them
- > engaging, influencing and understanding the role of expanding players, particularly China and India
- > the future balance between governance-related activities and other activities such as support for service delivery in Australia's aid to the countries of the region
- > the division of labour between Australia and other donors and future approaches to alignment and harmonisation
- > the need for, and requirements of, a specific fragile states development strategy for particular poorly performing East Asian partners
- > the value of establishing longer term graduation strategies in more rapidly developing economies
- > role of the aid program in helping to manage the threat of pandemics

HIV/AIDS

Globally, the HIV/AIDS pandemic shows no signs of abating. An 'epidemic equilibrium' or plateau is nowhere in sight. Prospects for a vaccine or cure are remote. HIV/AIDS and its consequences threaten to reverse the gains to development that have been made in many countries.

Much of the international HIV/AIDS focus to date has been centred on Africa. With the Asia-Pacific region accounting for 20 per cent of people living with HIV/AIDS in the world today, Australia has taken a leadership role to ensure the region receives appropriate global attention. Yet the current and potential impact of the epidemic on the region is still not commanding the attention that it merits.

The Global Fund to Fight AIDS, TB and Malaria has attracted significantly enhanced resources to the global HIV/AIDS effort, but effective use of these resources is proving challenging particularly in countries with severely restricted implementation capacity. In 2004-05 UNAIDS and major donors including Australia committed to actions to support country led responses through implementing the 'Three Ones', which encompass principles for unified national responses and donor harmonization to achieve more effective resource utilisation.

A significant epicentre of the disease is rapidly emerging to our near north, most notably in Papua New Guinea and parts of Indonesia including Papua Province. In many parts of Asia, intravenous drug use is now the most prevalent means of HIV transmission. Although the Pacific still has relatively low HIV prevalence rates, high rates of other sexually transmitted infections, travel patterns and demographic factors indicate a significant risk that Pacific island countries will be heavily impacted by HIV/AIDS in the medium term.

Increasing prevalence rates combined with high risk behaviour among many groups throughout the region indicate the need for urgent and comprehensive action. The high level of mobility throughout region, with many mobile people engaging in high-risk behaviour, further highlights the need for close regional cooperation.

The threat of HIV/AIDS is growing, not diminishing. In many parts of the region, political and community leadership is grossly inadequate. National responses are typically significantly below that which is required to avert a full blown crisis. While there has been some success in combating the spread of the disease, as in Thailand, countries such as Papua New Guinea and Cambodia will soon be facing levels of infection similar to sub-Saharan Africa unless strong, sustained political commitment and action is undertaken.

Australia launched its *International HIV/AIDS Strategy* in July 2004, with funding totaling \$600 million for the decade 2000–2010. Features of the Australian response have been significant investments in Papua New Guinea and Indonesia, regional projects for Asia and the Pacific, bilateral support to prevention and care programs in China, Vietnam, Laos, Cambodia, and South Asia, and support to NGOs active in Africa.

Recognising the significant reservoir of skills and expertise that has been developed domestically on HIV/AIDS, in 2004–05 AusAID launched a \$5 million partnership program to fund Australian professional and peak organisations to conduct capacity building work with partners in the region.

Australia has also donated \$25 million to the Global Fund over 3 years, contributes over \$3 million per annum to UNAIDS, and is a major sponsor of the Asia Pacific Leadership Forum on HIV/AIDS and Development.

Pragmatism and national leadership at the highest levels are critically important if HIV/AIDS is to be addressed effectively. Ministers attending the South-West Pacific Dialogue meeting in December 2004 made a commitment to work together on this issue. In particular, to inform a scaled up response the governments of Papua New Guinea, Indonesia, East Timor and Australia are undertaking a collaborative study on the social and economic risks posed by HIV/AIDS to the sub-region.

In addressing the Generic Questions posed on page 1-10, particular issues to be considered by the analytical team and Core Group include:

- > emerging issues on HIV/AIDS over the next 5 to 10 years (e.g. feminisation, security, stability and cross border issues)
- > role, if any, for Australia in responding to HIV/AIDS in South Asia and Africa
- > balancing bilateral, regional and global approaches and between prevention and treatment
- > arguments for 'emergency' responses at critical focal points and the objectives, expectations, approaches and resource requirements for such a response
- > strength of regional leadership and how to leverage it
- > bringing the broader HIV/AIDS community into the regional response
- > Australia's partnerships with major donors, regional countries, and international bodies.

AUSTRALIAN ENGAGEMENT

The Government relies on the Australian community to inform and implement its aid program. Effective partnerships with key groups will be critical to achieving the program's medium term goals and objectives.

There are five main groups involved in this engagement:

- > **Business and Industry** who invest significantly in the region and play a key role in generating growth, employment and revenue for recipient governments. Many companies have a deep understanding of individual economies. Private sector contractors play a role in implementing the aid program.
- > **Community based organisations** who play a role in implementing and informing the aid program and, separately, play an advocacy role on development.
- > **Members of Parliament** who participate in parliamentary oversight committees and on official delegations to developing countries and who play a key role in support of the program.

- > **Media** groups and journalists that serve to critique and educate the public on development issues and influence government.
- > **Research and academic institutions** that provide deeper analysis and thinking on a range of issues relevant to the aid program.

Business and Industry

Australian businesses invest significantly in the region and are key sources of finance and technology transfer to many countries in the immediate neighbourhood. Such businesses represent, therefore, key partners for generating growth and employment. The aid program has been able to tap into this source of knowledge and expertise to a limited extent, e.g. Australia-PNG Business Council. There is clearly an opportunity to build on these partnerships and draw these interests more into policy formulation and programming. For example, more consideration could be given to how Australian business might be drawn into efforts on broad based growth. This could include stimulating private sector development and a positive engagement with local factors of production, informed by development considerations such as sustainability. Assistance with risk, venture and opportunity identification could also be contributions. The private sector's role in helping to combat HIV/AIDS should also be considered, as well their role in conducting community based development activities.

Australia has invested for thirty years in a development contracting industry. Over this time, the domestic industry has developed under the umbrella of the tied aid provisions of the program. Many parts of the contracting industry are heavily dependent on the Australian aid program for the bulk of their income. While some parts of the industry have broadened their revenue base, there is a need to subject the Australian aid market to more competition.

There needs to be ways to tap into the expertise of the industry more effectively and encourage them to respond to the recent intellectual challenges of development. Beyond the delivery mechanism provided by the development contracting industry, more thought should be given to increasing business and industry involvement in the aid program.

Community Based Organisations

Community based organizations (CBO), including volunteer organisations, provide sources of advice and implementation from the community, and play an important role in generating public support for the aid program. The growth in volunteering amongst all ages of the population is one of the most practical and substantive avenues for a growing Australian understanding of aid and development issues. Sharing volunteer experiences in the Australian community is a key means of expanding Australian community engagement.

Partnerships arrangements and networks have evolved over the years. The environment in which the CBO community engages in the aid program has changed dramatically over the last ten years: humanitarian and disaster interventions are larger and more challenging, the security situation in our region more complex, the personal security of aid workers less assured and public expectations of aid responses higher. The Australian Council for International Development has played its role as the peak body for the non government organisation sector amid significant changes, including greater accountability requirements. The Committee for Development Cooperation was developed when engagements between the CBO sector and the aid program were much more limited than they are today, and its role could bear review after over 100 meetings spanning nearly thirty years. First and foremost, however, it is important to explore the best ways to engage most effectively with the substantial number of CBO members and their leadership in furthering Australian interests in the region.

Nearly fifty community organisations receive funding from the aid program to undertake their work in support of the program's objective and country strategies, and the mechanisms for their funding have changed as well. The White Paper process is a significant opportunity to review whether this limited group should be expanded. These include larger domestic community groups such as Lions and Rotary, community representatives such as local government authorities, specialist and professional groups in the community whose work does not fit the traditional "community development" model. Alternatively, can the aid program facilitate in a

cost effective way linkages between the Australian community and communities overseas?

Members of Parliament

Members of Parliament serve in a number of capacities of relevance to the aid program. At one level they represent the interests of their constituents and can be a supporter or critic of aid, and serve as an informer to the broader public on the role and achievements of Australia's aid program. At another level, certain members of Parliament serve on key oversight committees on the aid program. These include the Senate Legislative Committees (which oversee budget appropriations), and the Joint Standing Committee on Foreign Affairs and Trade and its Human Rights Sub-committee which conduct public inquiries of direct relevance to parts of the aid program. Such inquiries and their committees can have significant influence on the program. From time to time, Members of state parliaments are involved in various activities relevant to the aid program. Finding means to build more substantive links between Parliamentarians and the program and using Parliamentarians as a key source of advice to their counterparts in the region is an important challenge.

Academia and Research Institutions

The availability of timely and relevant research and analysis, as well as over the horizon new thinking has always been essential to an effective aid program. This need will only increase in the future. Alongside more traditional sources of development research such as the Australian National University, privately and publicly funded think tanks such as the Australian Strategic Policy Institute and the Lowy Institute are providing new policy focused analysis and research. Internationally, global development thinking is influenced by research bodies such as the World Bank's Development Research Group, the UK's Overseas Development Institute(ODI) and the US based Center for Global Development (CGD).

The aid program has been focused on commissioning specific pieces of research (e.g. economic and social impact of AIDS in PNG) together with some limited form of research partnerships, for example the State, Society and

Governance in Melanesia Project. The aid program has also supported relevant international research (e.g. CGD's commitment to development index work and ODI's research on humanitarian and conflict assistance). More recent work in AusAID is moving the research program more in the direction of longer term partnerships e.g. water, HIV/AIDS.

Academic institutions are also major implementers of the Australian aid program. Each year some 2,500 students from developing countries study at Australian universities and colleges funded under the aid program. The number of scholarships are set to increase significantly under the new aid program to Indonesia (AIPRD).

Media

The aid program faces increasing contestability to demonstrate to the Government, media and public tangible outcomes from Australia's aid investment in the region. The scrutiny of aid has been heightened, resulting in greater public awareness, an increased demand for accountability, an increased potential for criticism and greater opportunities to generate awareness and debate on aid issues.

To ensure high quality, effective participatory communication with the public and stakeholders, AusAID must ensure that it shares information and knowledge in a timely manner and operates in a transparent and accountable fashion.

KNOWLEDGE MANAGEMENT

In a context where Australian aid is typically small, we need to make sure that ideas and approaches piloted through the Australian aid program are promulgated and replicated more widely and effectively - 'knowledge-sharing of our key learnings'.

In addressing the Generic Questions posed on page 1-10, particular issues to be considered by the analytical team and Core Group include:

- > constraints and opportunities to improving key partnerships
- > encouraging Australian business engagement in the aid program and development more generally
- > opportunities to enhance the efficiency of the domestic contracting industry

- > the value of greater engagement with host country CBOs and the balance between that and engagement with developed country CBOs
- > opportunities to build stronger links with members of parliament
- > generating a greater media role in public diplomacy on aid and development.
- > creating better institutional links between community partners in Australia and their counterparts in developing countries (academic, media, business, community)
- > enhancing knowledge management between AusAID and the Australian community and internationally.

REPORTING REQUIREMENTS

The Core Group's report to the Minister is due in early December 2005. Individual analytical reports are due in mid-August 2005.

The individual analyses and Core Group's report will be informed through broad consultation including the use of themed and targeted seminars chaired by the Parliamentary Secretary for Foreign Affairs and Trade, video conferences with regional and international players, and dialogues conducted electronically with key experts.



2

Major Reviews and Ministerial Statements on the Australian Aid Program

The Australian Development Assistance Agency (ADAA) was established in 1974 as a new authority under the Minister for Foreign Affairs. ADAA brought together roles performed by different departments relating to aid, including to Papua New Guinea under pre-independence arrangements and the Colombo Plan which began in the 1950s.

In 1976 ADAA became the Australian Development Assistance Bureau (ADAB) and joined the Foreign Affairs portfolio. ADAB then became the Australian International Development Assistance Bureau (AIDAB) in 1987, and in 1995 became AusAID, the Australian Agency for International Development.

Between 1973 and 1983 there were at least eighteen reviews of various aspects of the Australian aid program. These reviews focused on finance and administration rather than setting policy directions or assessing the effectiveness of the aid program.

JACKSON REPORT

The 1984 Jackson Report was the first comprehensive review of the Australian aid program. It stated that:

“The Australian aid program is intended to achieve three broad goals which reinforce each other: the promotion of humanitarian ideals, and the advancement of the strategic interests and of the economic interests of Australia and the developing countries.” (Jackson, 1984: p.24)

The significance of the *Jackson Report* lay in its recognition of the aid program as unique in both its focus and approach. It emphasised the need for policies and management arrangements that were coherent and focused on the individual needs of Australia’s partner countries (i.e. country programming). It also recommended the gradual normalisation of the aid relationship to Papua New Guinea from budget support to a more traditional bilateral country program. The *Jackson Report* was formally supported by the Government following a 1985 report by the Joint Committee on Foreign Affairs and Defence.

The then Minister identified the need for significant reform to achieve aid policy objectives and promote the effectiveness of the aid program. As a result, ADAB was given much greater autonomy within the Department of Foreign Affairs, with the Director General reporting directly to the Minister and having authority to control agency resources. Also, a more structured and planned approach to development assistance was introduced, based on country programming and emphasis was placed on increasing the professionalism of the aid program and its staff.

A parliamentary review of the aid program conducted five years after the Jackson Report by the Joint Committee on Foreign Affairs, Defence and Trade found that the new aid policies and management reforms had been firmly entrenched in the Agency’s delivery of aid, making it an ‘efficient organisation capable of achieving [its] objectives’ (JCFADT 1989, p. 129).

SIMONS REPORT AND BETTER AID FOR A BETTER FUTURE

The 1997 *Simons Report* of the Australian aid program was the first substantial policy review since the *Jackson Report*. *Better Aid for a Better Future*, the 1997 Ministerial Statement on the aid program responded to the report. It established a single objective, in place of the three-pronged objective (humanitarian, commercial and foreign policy) that had emerged in the early 1990s and which had been subject to significant discussion. That single objective, which is still the **objective** today, being:

“To advance Australia’s national interest by assisting developing countries to reduce poverty and achieve sustainable development.” (Downer, 1997: p.3)

As part of the then incoming Government’s election platform, and consistent with the removal of the commercial objective of the aid program, the concessional lending scheme, the Development Import Finance Facility (DIFF) was abolished in 1997. DIFF provided grant funds to soften the terms of loans to developing country governments for development related projects put forward by Australian companies.

Better Aid for a Better Future stated that the aid program, together with all other Government programs, must work in the national interest and play its part in creating a prosperous and stable future for Australia. This statement was consistent with the White Paper on Foreign Affairs and Trade prepared in 1997, *In the National Interest*. *Better Aid for a Better Future* drew a clear link between the national interest and an effective and well-targeted aid program, focused on the alleviation of poverty and the promotion of sustainable development. Other outcomes included the establishment of a committee to provide advice to the Minister on aid and development issues, and strategies to graduate fast-growing, middle income countries from assistance.

Importantly, *Better Aid for a Better Future* acknowledged governance as a specific focus for the Australian aid program for the first time. This focus on governance recognised the importance of competent, accountable, responsive and equitable policies and institutions for development, and capacity building became a key tool in efforts to improve governance.

SUBSEQUENT MINISTERIAL STATEMENTS

The response to the East Asia economic crisis was outlined in the 1999 *Ministerial Statement* and the importance of focusing on governance challenges was reiterated. The 2000 *Ministerial Statement* focused on priority assistance to East Timor and reflected Australia's commitment to assist East Timor's transformation into a viable, independent nation through reconstruction and development. This was augmented in the *Tenth Annual Statement to Parliament on Australia's Development Cooperation Program* of November 2000, which emphasised the importance of working in partnership with the region to build upon the aid program's contribution to peace, security and sustainable development.

The 2002 *Ministerial Statement, Investing in Growth, Stability and Prosperity*, reinforced the continuing relevance of the essential policies and single objective established in 1997, and brought them together under a policy framework that had evolved in response to the changing international and regional

environment. The Statement outlined **five guiding themes**:

1. Promoting improved governance and strengthening democratic processes;
2. Assisting developing countries to access and maximise benefits from trade and new information technologies;
3. Supporting stability and government legitimacy through improved delivery of basic services;
4. Strengthening regional security by enhancing partner governments' capacity to prevent conflict, enhance stability and manage transboundary challenges; and
5. Promoting sustainable approaches to the management of the environment and the use of scarce natural resources.

2005 MINISTERIAL STATEMENT

Significant global and regional events such as the tsunami, state failure and declining governance, instability, conflict, terrorism, the spread of HIV/AIDS and the emergence of new pandemics were the backdrop for the *Thirteenth Annual Ministerial Statement, Australian Aid: An Integrated Response*, presented in March 2005. It reaffirmed the 1997 objective of the aid program and reflected on the significant changes in aid delivery and management. The statement outlined Australia's integrated approach to governance and other development challenges in the region, particularly with regard to the new \$1 billion aid package to Indonesia as well as ongoing commitments in the Solomon Islands and Papua New Guinea. The statement explicitly identified the stimulation of economic growth as a key focus and placed particular importance on responding to transboundary threats.

On tabling the Thirteenth Statement, the Minister for Foreign Affairs announced his intention to present a White Paper on the Australian aid program in early 2006. The objective of the White Paper is to outline a medium term strategy for the future direction of the aid program.



3

Increases in Bilateral Official Development Assistance and Multilateral Development Finance

In September 2005, the Prime Minister announced Australia's goal to increase its overseas aid allocation to around A\$4 billion per year by 2010. This increase will represent a doubling of Australia's overseas aid from 2004 levels.

In his announcement, the Prime Minister stated that future increases in Australian aid will be conditional upon strengthened governance and reduced corruption in recipient countries and the

aid program will continue to be reviewed annually, to take into account the effectiveness of the application of additional resources.

In recent times a range of players in the international donor community have also announced commitments to increase aid budgets and sharpen or re-focus development efforts. This summary provides some context on the intended directions of a sample of bilateral and multilateral donors:

BILATERAL

DONOR AND ODA FINANCING GOAL	FOCUS OF ADDITIONAL RESOURCES
United Kingdom <i>0.7% of Gross National Income (GNI) by 2013</i>	<p>The UK's Department for International Development (DFID) have identified a number of priorities including:</p> <ul style="list-style-type: none"> > doubling bilateral aid to Africa > increasing allocations to HIV/AIDS related activities > increasing access to primary education for the world's poorest countries, and > a proposed International Finance Facility to bridge the gap between the amount of development funds currently allocated globally, and the amount estimated to be required to achieve the Millennium Development Goals by 2015. <p>There is also a focus on debt relief to heavily indebted poor countries to enable funds that would otherwise have been spent on debt servicing to be redirected to priorities such as infrastructure, health and education.</p> <p>Around 45% of DFID development funds are allocated through multilateral agencies, and bilateral allocations focus on budget support to maximise the use of local systems.</p>
European Commission <i>For 15 richest member states: ODA to reach 0.7% of GNI by 2015</i>	<p>The EC has adopted a collective ODA target of 0.56% GNI by 2010, in order to reach 0.7% overall by 2015. Five European states have already achieved the 0.7% ODA/GNI target (Denmark, Luxembourg, the Netherlands, Norway and Sweden). Some have established timetables to achieve the target by 2015, and new member states joining in 2004 will strive to increase to 0.33% over the same time.</p> <p>At least half of the additional funding to 2010 will be dedicated to sub-Saharan Africa.</p> <p>Proposals under public discussion include support for the International Finance Facility, improved coordination among European states and with International Financial Institutions, and continued and enhanced efforts in the area of debt relief.</p> <p>The EC will continue its special partnership with African, Caribbean and Pacific countries (the ACP) under the 2000 Cotonou Agreement with respect to trade and development assistance.</p> <p>Major initiatives include:</p> <ul style="list-style-type: none"> > an increase of US\$2.3 billion in 2006 and 2007 to the Global Fund to fight Aids, Tuberculosis and Malaria (GFATM) > provision of additional resources to international financial institutions to facilitate the G8's cancellation of 100% of outstanding debt of eligible heavily indebted poor countries > support for the International Finance Facility > a special fund called the Peace Facility for Africa to support work to improve peace and security in Africa > increased support to developing countries to build their capacity to trade.

DONOR AND ODA FINANCING GOAL	FOCUS OF ADDITIONAL RESOURCES
<p>Japan</p> <p><i>Increase ODA by US\$10 billion over the next five years (2005-2009) compared with its net ODA in 2004</i></p>	<p>The announced increase of ODA of US\$10 billion in 5 years is a continuation of Japan's efforts to achieve the 0.7% ODA/GNI target. As part that commitment, Japan has committed to double its aid to Africa in the next three years. Japan has also committed to provide the most debt relief to African HIPC's out of all creditor nations.</p> <p>Underpinning Japan's Africa-focused scaling up plans is the development of its overarching theme of 'human security'. Japan's shift towards the seven principles of 'human security' (started in 2003) is being mainstreamed in all its aid processes.</p> <p>Major new initiatives in Africa include:</p> <ul style="list-style-type: none"> > a health and development initiative providing US\$5 billion over 5 years > an increased contribution to the Global Fund to Fight AIDS, Tuberculosis and Malaria > enhanced support to Consolidation of Peace in Africa > increasing support to rural development, trade and investment for African countries. <p>Japan traditionally targeted much of its ODA to Asia, with US\$3.2 billion of US\$7 billion or 53.6% of bilateral ODA going to Asia in 2003.</p>
<p>United States</p> <p><i>Double aid to Sub-Saharan Africa between 2004 and 2010</i></p>	<p>The US plans to double assistance to Africa between 2004 and 2010, after doubling total US ODA between 2000 and 2004 through the MCA.</p> <p>Major initiatives includes:</p> <ul style="list-style-type: none"> > US\$1.2 billion over five years for prevention and treatment of malaria. > US\$674 million for humanitarian relief in Africa, including \$414 million for famine in the Horn of Africa. > US\$400 million increase in funding for the African Education Initiative (AIE) from 2007 to 2010 > US\$100 million in FY05 and \$660 million over five years to increase global capacity for peace support operations. <p>The United States currently provides assistance to more than 100 countries across four regions (Sub-Saharan Africa, Asia and the Near-East, Latin America and the Caribbean, and Europe and Eurasia). Major global activities include:</p> <ul style="list-style-type: none"> > the Millennium Challenge Account – which aims to provide US\$5 billion per year to countries that: rule justly, invest in their people and encourage economic freedom. > increased debt relief to highly indebted poor countries > a US\$15 billion Emergency Plan for AIDS relief.
<p>Canada</p> <p><i>Doubling of international assistance between 2001 and 2010 and sharpening its focus</i></p>	<p>Canada's International Policy Statement (2005) pledges to increase international assistance to 2010. This includes doubling aid to Africa between 2003-04 and 2008-09. While increasing volume, Canada is also sharpening its geographic and sectoral focus. The Canadian International Development Agency's (CIDA) scope for bilateral assistance will narrow from 155 to 25 core development partners by 2010. CIDA's sectoral focus will narrow to six sectors, and Canada will work on improving its whole-of-government collaboration.</p> <p>In association with increased allocations to Africa, the 2005 budget for the Canadian International Development Agency (CIDA) highlighted:</p> <ul style="list-style-type: none"> > a new debt relief initiative (C\$172 million) plus and additional C\$34 million contribution to the Heavily Indebted Poor Countries debt relief initiative > C\$425 million to support the humanitarian and reconstruction response to the Indian Ocean tsunami > C\$342 million in additional funding to combat diseases in developing countries, and an additional C\$100 million over five years to be allocated to peace and security initiatives.

MULTILATERAL

The **Asian Development Bank** (ADB) acknowledges that while the Asia-Pacific region is on track to meet the Millennium Development Goal (MDG) target of halving the proportion of people living on less than a dollar a day, it is unlikely to meet the goals for reducing non-income poverty. The ninth replenishment of the Bank's concessional lending arm, the Asian Development Fund (ADF IX), covering the period 1 January 2005 to 31 December 2008, will include:

- > a continued and sharpened focus on sustainable economic growth
- > inclusive social development, and
- > good governance.

These priorities will be supported by an emphasis on cross-cutting issues and thematic priorities of private sector development, regional cooperation, and the mainstreaming of environment and gender. There will also be a focus on using development results to improve development effectiveness and impact, recognising and rewarding performance, and staying engaged in weakly performing countries. In ADF IX donors also agreed to establish a grants program that will:

- (i) take into account the debt burden of development finance in the poorest countries
- (ii) assist poor countries in transition from post-conflict situations to peace and stability
- (iii) combat HIV/AIDS and other infectious diseases
- (iv) support priority technical assistance.

ADF IX includes an endorsed program of \$7 billion.

The **World Bank** International Development Association (IDA) is the part of the Bank that helps the poorest countries reduce poverty by providing interest-free loans and some grants for programs aimed at boosting economic growth and improving living conditions. Under the fourteenth replenishment of IDA, approximately \$33 billion will be made available to the world's 81 poorest countries during the next three years. This represents an approximately 25 percent increase in overall resources over the previous replenishment,

and is the largest expansion of IDA resources in two decades.

For the increased funds, IDA donors supported a renewed focus on:

- > stronger, broad-based economic growth as essential to enable poor countries to reach the ambitious goals of progress and human welfare embodied in the Millennium Development Goals
- > a large and growing need for investment in access by poor communities to clean water, better communications and reliable power – donors viewed IDA, which has a large and expanding infrastructure program, as a key instrument in meeting these requirements
- > fostering a better climate in poor countries for private investment, and a redoubling of innovative efforts to support entrepreneurship and vibrant domestic private sector growth.

IDA's financial support to poor countries will now take systematic account of vulnerability to debt. The countries facing the toughest debt problems – most of them in Sub-Saharan Africa – will get all of their support in the form of grants, while less debt-burdened countries will receive IDA's highly concessional long-term loans (interest-free credits with a maturity period of 40 years and a grace period of 10 years), or a mixture of grants and credits.

A key aspect of IDA's financial support to poor countries is the strong and transparent link to country performance on economic policies, governance and poverty reduction efforts. Donors supported a decision by the World Bank's Board to make IDA's performance assessments of countries – its country ratings – publicly available.

G8 proposals for multilateral debt cancellation:

Under the proposed Multilateral Debt Relief Initiative (MDRI), the World Bank, the International Monetary Fund (IMF) and the African Development Fund (ADF) have agreed to provide 100 percent debt cancellation to Heavily Indebted Poor Countries. (HIPC).

The MDRI provides additional financial support to HIPC countries toward reaching the Millennium Development Goals while ensuring that the financial capacities of the International Financial Institutions

to assist the poorest countries in the future are fully preserved. The World Bank's International Development Association (IDA) is expected to provide the bulk of the debt relief under the MDRI. In December 2005, the IDA Deputies unanimously endorsed the MDRI and its implementation under IDA guidelines. IDA Deputies also pledged significant future financing commitments to IDA in order ensure its long-term financial viability. The Bank's shareholders are expected to formally endorse the MDRI in January 2006.

IDA is expected to implement the new initiative beginning July 2006, which is the start of IDA's next fiscal year. The IMF and ADF plan to start implementation by January 2006.

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4

Summary of key points raised with the Core Group

As we have examined and contested the future directions of Australia's aid program over the last 8 months, we have benefited from the extensive consultation we have undertaken in developing these recommendations. The table below summarizes the issues raised at public meetings, in consultations, through emails from interested members of the public and organisations, to the White Paper Core Group and Secretariat and in representations to the Minister for Foreign Affairs, Mr Downer, or Parliamentary Secretary to the Minister, Mr Billson.

Many specific comments and recommendations were made at the public meetings and in more than eighty emailed and hard copy submissions. We would like to thank everyone who provided comments and suggestions. While it is not feasible to respond to all of them individually, especially those relating to specific countries, we have attempted to group views and suggestions under general headings in an effort to capture the main issues raised and indicate where they have informed and are dealt with and responded to in the report. We also provide a few additional comments where further clarification is provided.

SUBMISSION	CORE GROUP RESPONSE
OBJECTIVE, SIZE AND GEOGRAPHIC FOCUS OF THE AID PROGRAM	
Develop a timetable to increase Australia's aid flows to 0.7% of Gross National Income (GNI) .	While many, though not all, submissions welcomed the Prime Minister's announcement that Australia would increase its overseas aid allocation to about \$4 billion per year by 2010, some called on the government to go further and announce a timetable for an increase in aid to the targeted 0.7% of Gross National Income by 2015, agreed by UN member states. This is not an issue we considered. We support the increase announced by the Prime Minister - there is a real need and the potential to deliver this increase effectively. Translating this large increase in aid into effective development outcomes is the immediate challenge, and the one our report has focused on.
Use the Millennium Development Goals to articulate the poverty focus of the aid program and as a planning and organisational framework	The Millennium Development Goals (MDGs) are a set of global development objectives that countries are aiming to achieve by 2015. Various submissions argued that the aid program should be more closely aligned with the MDGs. Our response is in Ch. 4.
The current objective for the aid program (to advance Australia's national interest by assisting developing countries to reduce poverty and achieve sustainable development) gives too much emphasis to Australia's national interest .	We note in the report that the reduction of poverty is both a humanitarian obligation and in Australia's national interest. We do note, however, that the phrase "national interest" in the objective was misinterpreted by several stakeholders as defining some narrower sense of self-interest, and argue that reducing poverty and advancing the national interest should not be seen as conflicting agendas for the aid program. See Ch.4.
Don't focus too narrowly on growth . Take a rights-based approach to development.	Our approach is set out in Ch. 4. We stress not only the importance of growth, but also of providing opportunities for all to participate in growth.
Different views were expressed on the geographic focus of the aid program. Many supported the current focus. Some argued for more focus in the Asia-Pacific on low-income countries. A few argued for more attention to Africa or other regions.	Our views on the geographic focus of the aid program are given in Ch. 7.

SUBMISSION	CORE GROUP RESPONSE
AID PRIORITIES AND DIRECTIONS	
Some argued that the strong focus of the aid program on governance was at odds with the objective of poverty reduction.	Good institutions are fundamental for poverty reduction, and a central focus on governance within the aid program is warranted. We do have several recommendations for how the objective of improving governance can be more effectively pursued. See the strategic framework presented in Ch.4 and for more details section 5.B.
Look for opportunities to increase the use of programs that engage with and support civil society to increase demand for good governance	See the discussion in section 5.B on functioning states and in section 6.C on linkages.
Make disaster management a more integral part of the aid program, and improve preparedness and coordination.	See the discussion in section 5.B on functioning states.
Find opportunities to increase support to micro-finance and micro-enterprise to foster local entrepreneurs	See the discussion in section 5.A on economic growth.
Australia should be very cautious about using the aid program to address land tenure issues – these are too sensitive, particularly in the Pacific	Our “middle-way” recommendations in this regard (in section 5.A) are based on a recognition that land tenure in the Pacific is an important, but sensitive issue, that change will take time and will have to come from within.
Focus on rural development as well as the need to address problems associated with rapid urbanisation	On rural development, see the discussion in section 5.A on economic growth. Concerning urbanisation, which we highlight as a major issue for the future in section 2.B, there are two challenges: infrastructure provision and employment generation. Our recommendations on these are also in the discussion in section 5.A.
Do more to support basic education and health in partner countries as a key part of Australia's aid program	See section 5.C ‘Investing in people’
Increase investment in Technical and Vocational Education and Training , particularly in the Pacific	See section 5.A ‘Economic growth’
Expand scholarships to build leadership.	See section 5.C ‘Investing in people’.
Do more to address HIV/AIDS in the region, whilst also maintaining a balance between this and other health issues	See our recommendations on HIV/AIDS in particular and health in general in section 5.C ‘Investing in people’. Several submissions noted the importance of drinking water and sanitation for health. We also note this in the report.
Several submissions advocated that the aid program should pay more attention to a number of specific health issues including disability, cancer, blindness, chronic and non-communicable diseases such as diabetes, and dental caries	A report such as this cannot go into the level of detail required to give attention to these items individually. We express, however, the general view that with regards to health the aid program should give priority to those health problems that cause the greatest burden – this may vary country-to-country. See section 5.C, ‘Investing in People’)
The aid program should do more to promote gender equality .	See the discussion in section 5.C ‘Investing in People’.
There were several conflicting submissions on the aid program's approach to family planning and related issues.	AusAID has guidelines in place to screen family planning proposals. These stress the importance of a voluntary approach. We endorse the use of the aid program to support family planning on these terms. We also recognize that economic growth and better education will tend to lead to smaller family sizes. We are not in favour of a requirement that some minimum proportion of the aid program be set aside for family planning activities. Several submissions were made that are critical of the role played by the United Nations Population Fund (UNFPA), especially in the Philippines. Our understanding is that both AusAID and UNFPA are promoting voluntary and appropriate approaches to family planning, and that continued support to UNFPA is warranted. See the discussion in section 5.C on investing in people, and in section 6.D on partnerships.

SUBMISSION	CORE GROUP RESPONSE
Give more attention to environmental sustainability , including renewable energy.	We agree that environmental challenges are going to become more acute in the coming years, and recommend that AusAID develop a new environment strategy (see section 5.A 'Economic growth').
Support for increased transparency in natural resource sectors , including the Extractive Industries Transparency Initiative.	See the discussion in section 6.B 'Combating corruption.'
Give more support to regional initiatives	See Section 5.D 'Regional stability and cooperation'. Some of the aid initiatives we support are also regional in nature
AID EFFECTIVENESS	
Do more to address corruption which distorts and diverts aid funding from where it is needed most	See section 5.B 'Functioning and effective states' and 6.B 'Combating corruption' for our analysis and recommendations.
Some submissions provided useful advice on how technical assistance and other sorts of assistance can be most effectively provided (e.g. stressing the need for flexibility, taking a long-term approach).	Several of these are picked up in the discussion of technical assistance in section 5.B 'Functioning and effective states', and in the discussion in section 6.D on partnerships.
Make greater and more effective use of Non Government Organisations and other Australian community-based groups and individuals in the design, implementation and evaluation of aid program activities. Do more to promote linkages (e.g. with schools, local governments).	See the discussion in section 6.C 'Integrating and broadening Australia's engagement with the Asia-Pacific region.'
Give more funding to ACIAR to expand agricultural research . Improve links between AusAID and ACIAR.	See the discussion in on research in Section 6.C.
Several submissions stressed the need for improved evaluation and knowledge management practices within the Australian aid program, including capacity to monitor and evaluate Whole-of-Government development assistance. There was support for using output-based aid.	For our recommendations on strengthening evaluation, see section 6.A 'Strengthening performance orientation'
Increase the aid program's ability to work with the private sector – both in Australia and in developing partner countries	See the discussion in Section 5.A on economic growth, and in sections 6.C and 6.D on linkages and partnerships.
A small number suggested the aid program should exclusively use Australian personnel, products and expertise , while others proposed that the aid program should become completely untied so that the best quality inputs can be assembled, no matter where they are sourced.	We recommend the full untying of Australia's aid program (see Ch. 8).
The whole-of-government approach (involving several departments to deliver aid) needs to be better coordinated.	See the discussion in section 6.C 'Integrating and broadening Australia's engagement in the Asia-Pacific region'
Strengthen AusAID in-house analytical and technical capacity	See the discussion on the challenges of scaling up in Chapter 8.
Various suggestions were made for where Australia might increase or decrease funding of multilateral agencies .	See the discussion on multilaterals, in section 6.D 'Working with partners'
Improve efforts in the area of donor harmonisation and alignment to reduce the burden on developing partner countries	See the discussion on these topics in section 6.D 'Working with partners'

SUBMISSION	CORE GROUP RESPONSE
NON-AID DEVELOPMENT ISSUES	
Expand migration opportunities, including by piloting a labour access scheme for the Pacific.	See the discussion under section 5.A under 'Building competitive work-forces', and in Ch. 7 in relation to the Pacific.
Various views were expressed on the benefit or otherwise of trade reform for developing countries	<p>We stress the benefits of global integration and market access for developing countries. We also recommend a continuing focus on assisting recipient countries to facilitate trade.</p> <p>(See section 2.C 'The international response to the challenge of development', section 3.A 'Development lessons' and section 5.A 'Economic Growth'.)</p>
Convert bilateral debt into agreed development initiatives using debt for development swaps	The debt swap recommended involves purchasing an indebted country's foreign debt, converting the debt into local currency, and using the proceeds to finance development activities. In our view, Australia should continue to address unsustainable debt in partner countries primarily through multilateral initiatives such as the Heavily Indebted Poor Countries (HIPC) Initiative.



5

List of agencies and organisations consulted

The process of developing the Core Group's recommendations has been subject to extensive external consultation, collaboration and contestability of ideas. Opportunities to provide comment and input included consultations during the development of six analytical reports, four public meetings, a series of roundtables focussing on key issues for the aid program, and the invitation to provide any thoughts, comments or written contributions via the White Paper email address at any time. Hundreds

of individuals have participated – some as people who have worked or volunteered their services in aid related activities in the past or hope to do so in the future, some as members of community based organisations, and others as members of the community who are interested in the process of shaping Australia's aid program. In addition to these individuals, the following pages list the wide range of agencies and organisations who have participated in the process to date.

ANALYTICAL REPORTS – AGENCIES AND ORGANISATIONS CONSULTED

ANALYTICAL REPORT	AGENCY / ORGANISATION
Asia: Analytical report for the white paper on Australia's aid program	Asia Australia Institute
	Asia Institute of Management
	Asian Development Bank (ADB)
	Australian Embassy, Dili
	Australian Embassy, Hanoi
	Australian Embassy, Manila
	Australian Embassy, Phnom Penh
	Australian Government Departments
	Australian Treasury
	Bilateral Donors
	CARE
	Central Institute of Economic Management, Vietnam
	Department of Foreign Affairs and Trade (DFAT)
	European Commission (EC)
	International Finance Corporation (IFC)
	International Monetary Fund (IMF)
	Japanese International Cooperation Agency (JICA)
	Ministry of Commerce
	Ministry of Planning and Investment, Vietnam
	Office of National Assembly, Vietnam
	Party Economic Commission, Vietnam
	Philippine Institute of Development Studies
	Prime Minister's Research Council, Vietnam
	United Nations Development Program (UNDP)
	United Nations Office in Timor-Leste (UNOTIL)
	United Nations Population Fund (UNFPA)
	United States Agency for International Development (USAID)
	World Bank
	World Health Organisation WHO

ANALYTICAL REPORT	AGENCY / ORGANISATION
Indonesia: Analytical report for the white paper on Australia's aid program	Indonesian National Development Planning Agency, BAPPENAS
	International Economic Cooperation, Coordinating Ministry for Economic Affairs (CMEA)
	National Committee for the Acceleration of Infrastructure Provision (KKPPI)
	Asian Law Centre, University of Melbourne
	Asian Development Bank (ADB)
	Australia-Indonesia Institute
	Australia-Indonesia Partnership for Reconstruction and Development (AIPRD)
	Australian Centre for International Agricultural Research (ACIAR)
	Australian Department of Foreign Affairs and Trade (DFAT)
	Australian Embassy, Indonesia
	Australian Treasury
	AusAID
	AusAID project team leaders
	Bank (Bank Negara Indonesia) BNI
	Business Enabling Environment, International Finance Corporation (IFC)
	Centre for Economic and Development Studies, Indonesian Institute of Sciences
	Demography Program, ANU Research School of Social Sciences
	Department of Political and Social Change, ANU
	Faculty of Economics, University of Indonesia
	Ford Foundation
	National Commission on Violence Against Women
	Office of National Assessments
	Oxfam
	Research School of Pacific & Asian Studies, ANU
	United Kingdom Department for International Development (DfID)
	United Nations Development Program (UNDP)
	United Nations Special Ambassador for the MDGs
	United Nations Support Facility for Indonesian Recovery (UNSFIR)
	World Bank
Pacific Island Countries: Analytical report for the white paper on Australia's aid program	Asia Pacific School of Economics and Government, ANU
	Asian Development Bank (ADB)
	Foundation for the Peoples of the South Pacific
	Pacific Islands Forum Secretariat
	Secretariat of the Pacific Community (SPC)
	United Nations Development Program (UNDP)
	Vanuatu Central Bank
	World Bank

ANALYTICAL REPORT	AGENCY / ORGANISATION
Papua New Guinea: Analytical report for the white paper on Australia's aid program	Asia Pacific School of Economics and Government and Research School of Pacific and Asian Studies, Australian National University
	Asian Development Bank, Port Moresby
	Asian Development Bank, Sydney
	AusAID
	AusAID project team leaders
	Australia—Papua New Guinea Business Council, Brisbane
	Australian Attorney-General's Department
	Australian Department of Foreign Affairs and Trade (DFAT)
	Australian Department of Finance and Administration
	Australian Department of Prime Minister and Cabinet
	Australian Federal Police
	Australian Treasury
	GRM International, Brisbane
	Institute of National Affairs, Papua New Guinea
	International Monetary Fund (IMF)
	JTA International, Brisbane
	Lowy Institute for International Policy, Sydney
	National Research Institute, Papua New Guinea
	Papua New Guinea Department of Community Development
	Papua New Guinea Department of Education
	Papua New Guinea Department of Health
	Papua New Guinea Department of National Planning and Rural Development (DNPRD)
	Papua New Guinea Department of Prime Minister and National Executive Council
	Papua New Guinea Department of Provincial and Local Government Affairs (DPLGA)
	Papua New Guinea Department of Treasury
	Papua New Guinea NGO—civil society representatives
	University of Papua New Guinea
	World Bank, Port Moresby
	World Bank, Sydney

ANALYTICAL REPORT	AGENCY / ORGANISATION
HIV/AIDS in the Asia Pacific Region: Analytical report for the white paper on Australia's aid program	ACIL Australia Pty Ltd
	Albion Street Centre, South East Sydney Area Health Service
	Australasian Society for HIV Medicine
	Australian Council for International Development
	Australian Department of Health and Ageing
	Australian Federation of AIDS Organisations
	Australian Injecting and Illicit Drug Users league
	Australian Red Cross
	Australian Research Centre in Sex, Health & Society
	Burnet Institute, Centre for Harm Reduction
	Caritas
	Curtin University Centre for International Health
	Union Aid Abroad – APHEDA
	Gender Studies, ANU
	Global Fund to fight HIV/AIDS, TB and Malaria
	GRM International Pty Ltd
	HIV & STI Committee of the Ministerial Advisory Council on HIV/AIDS, Sexual Health & Hepatitis
	International Committee Red Cross
	Lowy Institute for International Policy
	Melbourne University Private
	National Association of People Living with HIV/AIDS
	National Centre in HIV Epidemiology & Clinical Research
	National Centre in HIV Social Research
	National Drug and Alcohol Research Centre
	National Serology Reference Laboratory
	Oxfam Community Aid Abroad
	Pacific Islands Forum Secretariat
	Political Sciences Department, La Trobe University
	Political Sciences Department, ANU
	Scarlet Alliance
	Secretariat of the Pacific Community
	UNAIDS Bangkok Regional Support Team
	UNAIDS Geneva
	United States Agency for International Development (USAID), Bangkok Office
	UNICEF
	United Nations Population Fund (UNFPA)
	World Vision
	World Health Organisation (WHO)

ANALYTICAL REPORT	AGENCY / ORGANISATION
Engaging the Australian Community: Analytical report for the white paper on Australia's aid program	ABC Radio Australia
	Abyss Pictures
	ACIL Australia Pty Ltd
	ACUS Tanks
	Adelaide Advertiser
	Adelaide Graduate Centre, The University of Adelaide
	Anglicord
	Asia Research Centre, Murdoch University
	Austcare
	Australia Fiji Business Council
	Australian Conservation Foundation
	Australian Council for International Development
	Australian Foundation for the Peoples of Asia and the Pacific
	Australian Mekong Resource Centre, The University of Sydney
	Australian Red Cross
	Australian Volunteers International
	Austraining International
	Business Development, International Development, GHD P/L
	Business Development, URS Sustainable development
	CARE Australia
	Centre for International Health, Burnet Institute
	Centre for Tourism & Risk Management, University of Queensland
	Christian Blind Mission International Australia
	Consulting Services, World Vision Australia
	Cooperative Research Centre for Plant-based Management of Dryland Salinity, The University of Western Australia
	Corporate Policy and Projects, Austrade
	Deacons
	Department of Infectious Diseases, Southern Health
	Development Assistance, Sinclair Knight Merz
	Development Studies Network, Australian National University
	Director Business Lines and Major Projects Asia-Pacific, URS Australia Pty Ltd
	Engineers Without Borders Australia
	Faculty of Health Sciences, The University of Adelaide
	Fellowship and External Affairs, Royal Australasian College of Surgeons
	Foundation for Development Cooperation
	Gordon Eye Surgery
	Griffith Business School, Griffith University
	Griffith Asia Institute, Griffith University
	Hassall & Associates
	Health Professionals Insurance Australia Pty Ltd
	Industry Capability Network (Vic) Ltd
	Institute of Public Affairs Limited
	International Aid and Development Business Unit, Queensland Department of the Premier and Cabinet

ANALYTICAL REPORT	AGENCY / ORGANISATION
	International Centre, The University of Western Australia
	International Development Assistance, Connell Wagner
	International Development Business Unit, W.A Department Industry & Resources
	International Development Support Services Pty Ltd
	International Marketing, Griffith University
	International Office, Curtin University of Technology
	International Programs, National Council of Churches in Australia
	International Student Centre, The University of Adelaide
	JTA International
	Leadership Management Australia
	Lowy Institute for International Policy
	Macquarie Bank Foundation, Macquarie Bank Limited
	National Association of People Living with AIDS
	National Events and International Liaison, Australian Local Government Association
	Nestle Pacific Islands
	Pacific Asia Programs, Marie Stopes International Australia
	Plastic and Reconstructive Surgery, Interplast Australia
	Policy and Research, Australian Local Government Association
	Politics Department, The University of Adelaide
	Quaker Service Australia
	Queensland Education and Training International, Queensland Department of the Premier and Cabinet
	Research Institute for Asia and the Pacific, The University of Sydney
	Research Institute for Humanities and Social Sciences, The University of Sydney
	RMIT International
	Rotary Australia World Community Service
	Rotary Club of Mount Gambier West
	SAGRIC International Pty Ltd
	SAI Global
	Save the Children Australia
	School of International Development, Melbourne University Private
	School of Journalism and Communication, University of Queensland
	School of Journalism and Communication, University of Queensland
	School of Management, University of Technology Sydney
	Strategic Policy and Research, Department for Victorian Communities
	SurfAid
	Trade and International Affairs, Australian Chamber of Commerce and Industry
	WaterAid Australia

LIST OF SUBMISSIONS RECEIVED:

[Note: In total, more than 80 submissions were received. Of these, around 30 were from individuals – their names have not been included in this list for privacy reasons]

ACIL Australia Pty Ltd
ACROD (National Industry Association for Disability Services)
All Saints Anglican Church, Nelson Bay
ATSE Crawford Fund
Australian Conservation Foundation
Australian Council for International Development (ACFID)
ACFID Disability and Development Working Group
Australian Red Cross
Australian Reproductive Health Alliance
Belleng Pty Ltd
Cancer Council Australia
Caritas Australia
Child Wise
Council on Australia Latin America Relations
Credit Union Foundation Australia (CUSCAL)
Director Education Asia Pacific
Education Queensland International
Evangelical Alliance
Family Life Australia
Fred Hollows Foundation
Foundation for Development Cooperation
George Institute for International Health
Global Filipinos Australia
Grameen Foundation Australia
Human Rights Watch
INDEVELOPMENT
International Development Contractors (IDC)
Jubilee Australia
Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church of Australia
Macedonian Weekly (newspaper)
Marie Stopes International Australia
Morawetz Social Justice Fund
Oaktree Foundation

Opportunity International Australia
Oxfam Australia
Parliamentary Group on Population and Development
PolMin: Australian Political Ministry Network
Publish What You Pay
Quaker Service Australia
RESULTS Australia
Royal Children's Hospital International
SkyJuice Foundation
SGSDA Trade and Investment
Vision 2020
Water Aid Australia
Western Australian Department of Agriculture
Women's Plans Foundation
World Education Australia
World Vision Australia
WWF-Australia

ORGANISATIONS REPRESENTED AT TARGETED SEMINARS AND ROUNDTABLES ON KEY ISSUES FOR THE AID PROGRAM:

In many cases a wider group was invited to attend – the lists below are actual attendees at each session.

TRANSBOUNDARY ISSUES (BRISBANE, 29 AUGUST)

Institute of Health and Biomedical Innovation and QUT International, Queensland University of Technology
Griffith Asia Institute, Griffith University
School of Public Health, Tropical Medicine and Rehabilitation sciences, James Cook University
Tropical Public Health Unit, Queensland Health
Tropical and Emerging infectious Diseases Division, Menzies School of Health Research
JTA International
National Centre for Social Application of Geographic Information Systems, University of Adelaide
CSIRO Australian Animal Health Laboratory (AAHL)

GROWTH AND THE INVESTMENT CLIMATE IN THE ASIA PACIFIC (CANBERRA 7 SEPTEMBER)

Institute of International Business and Law,
University of Adelaide
Centre for International Economics
Centre for Independent Studies
Australia-Fiji and Australia-PNG and Australia-Pacific Islands Business Councils
Exxon Mobil Australia
Australia South Asia Research Centre, Australian National University
Australian Treasury

POLITICAL GOVERNANCE IN THE ASIA PACIFIC (CANBERRA, 7 SEPTEMBER)

Parliamentary Secretary to the Minister for Foreign Affairs, Mr Bruce Billson (Liberal Party of Australia)
Member for Maribyrnong, Mr Bob Sercombe, MP (Australian Labor Party)
Member for Fraser, Bob McMullan MP (Australian Labor Party)
Member for Denison, Mr Duncan Kerr, MP (Australian Labor Party)
Senator for South Australia, Senator Alan Ferguson, (Liberal Party of Australia)
Senator for New South Wales, Senator Marise Payne, (Liberal Party of Australia)

INSTITUTE HEADS (SYDNEY, 18 OCTOBER)

Overseas Development Institute
Lowy Institute for International Policy
Centre for Independent Studies
Centre for International Economics
Strategic and Defence Studies Centre, Australian National University

AUSTRALIAN COUNCIL FOR INTERNATIONAL DEVELOPMENT (CANBERRA, 18 OCTOBER)

Anglican Board of Mission
Australian Business Volunteers
Australian Conservation Foundation

ACROD – National Industry Association for Disability Services
AFAP – Australian Foundation for Peoples of Asia and the Pacific
Australian Red Cross
ARHA – Australian Reproductive Health Alliance
Australian Council for International Development
Burnet Institute
Baptist World Aid Australia
Caritas
Christian Blind Mission International
Childfund (formerly Christian Children's Fund)
Fred Hollows Foundation
Habitat
Marie Stopes International Australia
Oxfam Community Aid Abroad
Plan
People with a Disability Australia
Quaker Service Australia
Sexual Health and Family Planning
TEAR
Unicef
World Vision Australia

AUSTRALIAN GOVERNMENT ROUNDTABLES (23-24 AUGUST)

Attorney-General's Department
Australian Centre for International Agricultural Research
Australian Federal Police
Australian Treasury
Department of Education, Science and Training
Department of Foreign Affairs and Trade
Department of Finance and Administration
Department of Health and Ageing
Department of Immigration and Multicultural and Indigenous Affairs
Department of the Environment and Heritage
Department of the Prime Minister and Cabinet
Office of National Assessments

UNITED NATIONS NEW YORK (OCTOBER)

Roundtables conducted on:
Multilateral Engagement and the Aid Program
Transboundary Issues in Asia Pacific

INTERNATIONAL VIDEOCONFERENCES:

Asian Development Bank (14 November)

Session 1:

Director General, Mekong
Director General, Operations Coordination Division
Director General, Pacific

Session 2:

Vice President, Operations
Vice President, Knowledge Management and Sustainable Development

WORLD BANK

Session 1: Aid Effectiveness and Evaluation
Director, Operations Evaluation Department
Sector Thematic and Global Evaluation
Corporate Evaluations and Methods
Director, Quality Assurance Group

Session 2: East Asia and Pacific

Director, Strategy and Operations
Chief Economist, East Asia and Pacific
Director, Infrastructure Sector
Lead Economist, Philippines

PUBLIC MEETINGS – ORGANISATIONS ATTENDING

In addition to several hundred individuals, below are the organisations that were represented at the four public meetings for the White Paper on the Australian aid program:

BRISBANE (2 AUGUST)

ACIL Australia
Advocacy and Release for Children
APEC International Centre for Sustainable Tourism (AICST)
Australian Centre for Peace and Conflict Studies at The University of Queensland
Australian Volunteers International
Barbar Assoc.
BLP Middle East (FZC)
Brisbane City Council
Brisbane City Enterprises
Cardno International
Cooke & Hopley
Department of Primary Industries and Fisheries
Department of the Premier and Cabinet
Disability Services Queensland
Education Queensland International
Faculty of Natural Resources, Agriculture and Veterinary Science, Uni of QLD
Gold Coast Home Loans
Griffith International, Griffith University
GRM International
John Davidson & Associates
JTA International
JWP
Management Training Cooperation
Middle East Reformed Fellowship
Nutrimix Distribution
Opportunity International
PMA International
PMM
PMT Water Engineering
Queensland Environmental Protection Agency

Queensland Education and Training International
 Queensland Fire & Rescue Service
 Queensland Health
 Queensland University of Technology
 Results Australia
 School Aid Trust
 Scripture Union International
 Southbank Institute
 Strategic Policy and Govt. Liaison Directorate
 Sunwater
 TEAR Australia
 Terranean Mapping Technologies
 The Carson Group
 The International Centre of Excellence in Tourism
 and Hospitality Education
 The University of Queensland
 The Wright Consultancy
 UN Assoc of Australia (QLD)
 UniQuest
 United Bible Societies
 World Vision
 WRM Water & Environment

MELBOURNE (8 AUGUST)

9800 Rotary Australia World Community Service
 ACIL
 AngliCORD
 Australia India Society
 Australian Business Volunteers
 Australian Foundation of people of the Asia and
 Pacific
 Australian Volunteers International
 Baker Legal
 Benchmark International
 Caulfield Community Health Service
 Centre for International Mental Health, Uni of
 Melbourne
 Childwise
 Ciptanet International
 Columban Mission Centre

Engineers Without Borders
 Ethnic Communities' Council of Victoria
 Evangelical Alliance
 Ford Motor Company of Australia
 GIM International (Melbourne)
 Global Institute for Macedonian Advancement
 Heritage Properties Australia
 Institute for Citizenship and Globalisation, Deakin
 University
 International Operations Department, Australian
 Red Cross
 Interplast Australia
 JTA International
 La Trobe University
 Monash Asia Institute
 RMIT University
 Rotary Australia World Community Service
 Royal Australasian College of Surgeons
 Royal Children's Hospital Emergency Department
 Royal Children's Hospital International
 Soroptimist International Region of Victoria
 TEAR Australia
 The Centre for International Mental Health
 The Crawford Fund
 The Intrepid Foundation
 Uniting Church in Australia
 University of Melbourne
 WaterAid Australia
 William Angliss Institute of TAFE
 World Vision Australia
 Youth Central

PERTH (19 SEPTEMBER)

Amnesty International Australia
 Anglo-Burmese Society Inc
 Asia Research Centre, Murdoch University
 Australian Dental Association
 BDO Perth
 Belleng Pty Ltd
 Curtin University of Technology

Department of Agriculture, Government of Western Australia
 Edith Cowan University
 Father Brian Crisis Centre
 Foundation of Goodness (from Sri Lanka)
 King International Education Services
 Opportunity International
 Safety, Health & Welfare, Western Australia Police
 School of Social Work and Social Policy, University of South Australia
 State Solicitor's Office
 Trade, Migration and Development Research Centre, University of Western Australia
 WA Health Department

SYDNEY (21 SEPTEMBER)

AID/Watch
 Albany Associates
 APPA Network
 ASEAN Focus Group
 AusHeritage and the NSW government Architect's office
 Austcare
 Australia South African Business Council
 Australian Development Gateway
 Australian Expert Group in Industry Studies, University of Western Sydney
 Baker & McKenzie
 Baptist World Aid
 Bush Books
 Cambodia House
 Cancer Council, Australia
 Ceal Corporation
 Centre for the Advancement of International Health – University of Wollongong
 Community Health and TB Australia
 Credit Union Foundation Australia
 Crown Project Services
 Department of Art History and Theory, University of Sydney
 Dibbs Abbott Stillman Lawyers

Director Education Asia Pacific
 Emergency Management
 Family Life International
 Filipino Program
 Fred Hollows Foundation
 Galexo Consulting
 George Institute for International Health
 Global Filipinos Australia
 Global International Projects, UNSW
 Green Clover Productions
 Hoc Mai (Australian Vietnam Medical Foundation)
 Horizon Communication Group
 International Office, University of Sydney
 ITC International
 Jubilee Australia
 Lowy Institute for International Policy
 Australian Business Volunteers
 Micah Challenge
 Moore Communication
 National Council of Women NSW
 National Measurement Institute
 Net Return
 NSW Department of Community Services
 NSW Department of State and Regional Development
 Oxfam Australia
 Pacific Enterprise Development Facility, International Finance Corporation
 Pacific Liaison and Coordination Office, Asian Development Bank
 Parramatta City Council
 Partners in Micro-development Inc
 PDP Australia
 People with Disability Australia
 Quaker Service Australia
 Read McCarthy Group
 Research Institute for Asia Pacific, University of Sydney
 S. Hudson & Associates
 Sakhiwe Consultants Ltd

School of Economics and Political Science,
University of Sydney
School of Public Health and Community Medicine
UNSW
Sisters of Mercy
Skyjuice Foundation
TAFE Global
TAFE NSW
TEAR Australia
The Defence Force
The Hunger Project
The Research Institute for Asia and the Pacific
The World Bank
Tooth Aid Inc.
Tourism and Transport Forum
Union Aid Abroad - APHEDA
United Nations Information Centre - Australia and
the Pacific
University of Sydney
University of NSW
University Technology Sydney
WAYS Youth Services
Women's Plans Foundation
World Education Australia (NGO)



6

Asia

Analytical report for the White Paper on Australia's aid program

Prepared by
Dr Elsinä Wainwright and Ian Anderson

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Executive summary

THE STRATEGIC CONTEXT

1. The Asian story is important. Asia is home to more than half the world's population, and two thirds of the world's poor. It is also home to the fastest growing economies in the world, and by 2050 three of the four largest economies in the world – Japan, China, and India – could plausibly be in Asia. Asia has produced some of the most dramatic reductions in poverty in history, with India, China and Vietnam each halving their rates of poverty in a decade and lifting tens of millions out of poverty.

2. But growth is not uniform and poverty is still a major issue. Asia is home to seven of the world's Least Developed Countries or 12 Low Income Countries, a number of fragile states, and countries with longstanding and poor records of growth and stability such as the Philippines. North Korea and Burma have poor growth histories and prospects in the near term. Inequalities are also emerging within national borders. And, despite great progress, there are still more than 700 million people living on less than US\$1 a day in Asia. Importantly there are a further 1.9 billion living on less than US\$2 a day, who can be tipped back into extreme poverty by external shocks or changes in circumstances.

3. Regional power dynamics are changing, and regional stability in the next ten years will depend upon how the great power relationships evolve and how the region accommodates the economic and political rise of China and India. Growth is

amplifying the twin challenges of state strength and state weakness in Asia. Increasingly, national economic security for countries in the region will be determined by a country's access to export markets, its capacity to retain international competitiveness, and its secure access to resources, especially water and energy. Stability is also affected by the fact that the Asia and Pacific regions are home to at least five countries with nuclear weapons and at least three potential flashpoints (Korean peninsular, Taiwan Straits, Kashmir). Peaceful, democratic elections in Indonesia last year were important for stability in Indonesia and the region more generally. But there remain several longstanding internal insurgencies in Asia (including in the Southern Philippines, Nepal and Sri Lanka), and terrorism has emerged as a key issue in the region.

STRATEGIC DEVELOPMENT CHALLENGES IN ASIA

4. Asia faces enormous – and varied – development challenges, including poverty, economic, demographic, social, environmental, and health.

5. Some challenges require large funding. East Asia alone requires approximately US\$200 billion annually over each of the next five years if it is to alleviate the critical infrastructure bottlenecks already constraining growth. An estimated US\$30 to US\$40 per capita is needed annually to finance the minimum health service package in Asia, but Bangladesh, Cambodia, Laos, Pakistan, Mongolia,

and Vietnam all spend less than US\$10 per capita. Similar large-scale financing needs exist in the education sector.

6. Few growth and development challenges can be solved by money alone. Much important work can be achieved through ideas, good policy and good leadership. Asia has 88 million unemployed youth and the trend is worsening, with all that means for social and political stability in the region. Money alone will not solve this. Policies and institutions matter. Well designed aid can help shape the enabling environment for a vibrant private sector.

7. Some development challenges in Asia are longstanding and some are new. In the health sector alone, tuberculosis – an old enemy of the poor – kills 700,000 people a year in South-East Asia and infects a further three million. Polio has just re-emerged in Indonesia and there are relatively new and emerging challenges, including HIV/AIDS, SARS, and other pandemics.

8. How well Asia responds to such large and varied challenges will affect developments in the region and beyond. The breadth and depth of Australia's relations with Asia – economic, political, security, and environmental – means there are direct national interests at stake. Australia cannot disentangle itself from these challenges, or from Asia's responses to them. Nor should it.

AID: MAKING GOOD CHOICES

9. Australian aid has assisted development in Asia to date. It can do so in the coming decade too. But aid cannot – and should not – try to respond to every development challenge, especially in a region as large and varied as Asia. Making good choices about where, why, how, and for how long aid should be provided in Asia is critical to the effectiveness of Australia's engagement with the region.

10. Four principles should therefore be used to screen and prioritise broad strategic options for Australian aid in the region. The first principle is that aid should make a clear contribution to economic growth in Asia, as a necessary (although not sufficient) condition for stability, security, and poverty reduction in the region. The second principle

is that, given Australia's proximity to the region, priority should be given to aid activities that most align with Australia's national interests (broadly defined). The third principle is that, given the small size of aid relative to the challenges of the region, aid modalities need to be chosen which have the biggest long-term impact. The fourth principle is that, while strategic focus is important in Asia, so too is flexibility and the capacity to respond to the rapidly changing environment of the region (page 6-17).

11. This chapter offers a menu of prioritised choices for the Australian Government, together with recommendations for the coming decade. Some challenges and choices are thematic, focusing on what Australia should do. Other choices are more operational: 'how' we should do it. Still other choices are centred around programs and countries, focusing on where Australia should devote its attention and put its resources.

12. Common themes underpin these choices. Aid to Asia, for example, needs to be larger, bolder, more focused, and more modern. Ideas will count as much as money, although both will be needed.

RECOMMENDATIONS ON WHAT AUSTRALIA SHOULD DO

13. First, Australia should **consolidate its efforts** in sectors central to driving good quality growth and reform in Asia, such as economic governance and trade/economic integration. This is increasingly important as China and India expand their economic engagement within the region and beyond. All countries in Asia will have to manage the rapid structural change of their economies if they are to retain their international competitiveness and therefore their primary sources of growth. The Philippines and Indonesia face particular challenges here, given their declining competitiveness. But aid can play a catalytic and helpful role in supporting necessary economic reforms. Fine tuning of Australia's work on economic governance is also recommended to give more explicit attention to private sector growth and investment: these main drivers of sustainable growth in Asia may have been underplayed in Australia's strategies to date (pages 6-17).

14. Second, Australia should **significantly scale up** its engagement in certain sectors or the forms of aid which will increasingly drive growth and reform in Asia. For example, the Australian Development Scholarships program should be significantly expanded and further modernised, because scholarships can build supply *and* demand for reform within developing countries; drive reform from within; build the next generation of leaders and reformers; and build good people-to-people links. Tertiary education and scholarships can be potent forms of assistance in fragile states. Significant opportunities also exist for scaled up and high-impact engagement in the health sector where development issues and Australia's national interests closely coincide. Opportunities include an initiative for preparedness and response to pandemics; leveraging up the impact of some of the large funders of health in the region; addressing some larger system-wide failings of health service delivery; and helping to plug priority but overlooked public health needs. Similar strategic opportunities are available in education including upper secondary, tertiary, vocational, and girls' education (page 6-17).

15. Third, if Australia is to help shape the main drivers of change in Asia, then it needs to **work in new areas** not traditionally large in the aid program. Physical infrastructure (especially transport) and resources (especially energy) are key drivers of the level – and quality – of economic growth in Asia, and for this reason alone should attract more Australian attention. The nature of those massive investments will have profound environmental impacts on the region and, arguably, even on climate change globally. There is a great deal Australia could do to help shape the directions these large investments will take, including by through regulatory environment and governance arrangements of public infrastructure; promotion of clean and efficient energy; and conservation of water and other resources (page 6-22).

16. There is also a case for considering initiatives in the relatively new field of political governance, especially building up the *demand* side of reform and the *how* of reform (page 6-24).

RECOMMENDATIONS ON HOW AUSTRALIA DELIVERS AID TO ASIA IN THE COMING DECADE

17. Australia already has a number of comparative advantages in the way it approaches and delivers aid in the region. But if Australia is to increase its impact over the coming decade it needs to consider three changes in the way it delivers aid.

18. First, Australia needs to be much more strategic and proactive in the way it engages with the large **multilateral** development institutions operating in the region. The World Bank and Asian Development Bank (ADB) lending to Asia was more than US\$10 billion in 2004 – some 30 times larger than Australia's bilateral program to the region. The Global Fund to fight AIDS, Tuberculosis, Malaria – and similar new foundations – bring billions of dollars more to the region. Australia, an essentially grant donor with strong country presence and knowledge of the region, should be in a good position to leverage the policy and lending operations of such institutions. Even more importantly, however, Australia should contribute to the analytical, research, and advocacy agendas of these large, influential institutions in the coming decade (page 6-26).

19. Second, it needs to be recognised that **ideas** will be a more potent source of quality growth and development in much of modern Asia than will traditional technical assistance and projects. Australia should therefore pay more attention to supporting and disseminating analytical work and applied research on the *how* of reform; vigorously pursuing institutional links; promoting centers of excellence on priority issues directly relevant to Asia, including clean energy; and building people-to-people links to promote and sustain reform (page 6-27).

20. Third, **aid architecture** in Asia is rapidly changing and Australia needs to respond to, and help shape, these changes. At the **multilateral** level, the coming decade will see major changes to the way the World Bank and ADB engage in the region. The role of newer but potentially significant institutions like the Global Fund to fight AIDS, Tuberculosis and Malaria will also need attention. And many would argue that decisions made – or not made – under the World Trade Organization (WTO) will drive economic growth and development in a

globalising region like Asia. There are also important developments arising at a **regional** level in the coming decade, including the East Asian Summit, cooperation in the Mekong subregion, and similar initiatives. At the **bilateral** level, the coming decade will see the continued rise of new and important aid providers in the region (including China) at a time of when traditional Western donors change the levels and nature of their engagement and increasingly harmonise activities. **Non traditional development** – for example remittances and migration – will also be increasingly important in Asia in the next ten years although rapidly increasing cross border flows of money and people have ambiguous development impacts and carry security implications. There are policy, operational, and resource implications in all this for Australia, and AusAID (page 6-28).

RECOMMENDATIONS ON WHERE AUSTRALIA PROVIDES AID

21. Situations can change quickly at the country level in Asia and aid programs need to respond accordingly: the rapid and large scaling up of aid to post Tsunami Indonesia and elsewhere is the latest illustration of this. Looking ahead, a significant shift in North Korea or Burma could require large and rapid responses from Australia. Flexibility and nimbleness of aid at a country level are therefore important.

22. On the other hand, a ten-year time horizon – as offered by the White Paper – provides an opportunity to have an aid program that is strategic, focused and of sufficient duration that it can make real differences.

23. More specifically, **Indonesia** should, quite properly, be the largest and broadest development program Australia has in Asia in the coming decade: Indonesia's size, proximity and development challenges overlap with the national interests Australia has at stake with that country. For similar reasons, Australia should also continue with its broad spectrum relationship with **East Timor**, focused on maintaining stability, developing human capacity, and improving viable youth employment. In fragile states such as East Timor, Cambodia and the Philippines, young people are potential

agents for change in demanding reform. But they are also potential agents for instability, especially if unemployed. A development focus on education and employment opportunities for young people can therefore help promote governance and stability (page 6-30).

24. The **Philippines** – especially Southern Philippines – poses special developmental challenges and issues of national interest: innovative activities in education, building demand for reform and promoting stability in Mindanao may be the most fruitful strategic intervention. The **Mekong** region has special characteristics and opportunities for strategic aid engagement (pages 6-31 to 6-32).

25. Whether Australia should provide aid to fast-growing **China and India** in the coming decade is an important policy decision for Government. The arguments for and against this are discussed in this paper. A bold, forward-looking, flagship initiative for **East and South Asia** is canvassed that would demonstrate development impact and align closely with Australian national interests (pages 6-33 to 6-35).

CONCLUSION

26. Asia is large, highly varied and facing complex challenges that affect the lives of billions of people. How it responds to these challenges will directly affect Australia's national interests. Aid, though small, can help shape the response to these challenges, but it needs to be selective and sustained if it is to have impact.

27. The package of recommendations in this chapter are tailored to the special needs of a rapidly changing and varied Asia. Taken together, they seek to get to the heart of promoting durable reform in Asia. The recommendations are coherent and self reinforcing: shifting upstream to engage more on analytical and applied research that will complement an expanded and new generation of scholarships, institutional links, and enhanced engagement with the policy and analytical agendas of the multilateral development banks. Each element of the package can be applied in varying degrees to the differing country needs of Asia: from large and fast growing East and South Asia, to small and vulnerable fragile states.

Asia: the strategic and development context

A STORY OF GROWTH – AT LEAST FOR SOME

1.1 The Asian region has experienced remarkable economic growth over the last 15 years, halving the rate of poverty in countries like India, China and Vietnam in a decade. The region has rebounded from the 1997 financial crisis, and East Asia in particular has seen dramatic growth, with China averaging 9.7 per cent growth over the last ten years. Growth in South Asia has also been strong, largely due to the trajectory of India. Growth in the region looks set to proceed over the next decade, as China and India continue to benefit from – and themselves drive – trade. The world's economic centre of gravity will likely continue to shift to Asia: by 2050, based on current trends, China and India could well join the United States and Japan to form the four largest economies in the world.¹

1.2 Economic growth has brought opportunities to the region, including an increase in linkages between East, South-East and South Asia. The search for further growth and the desire to prevent another shock such as the 1997 financial crisis will likely keep driving regional trade, economic and financial cooperation efforts. The economic interdependence of the region has increased – at least among the economic reforming countries – and a number of

bilateral and regional trade agreements have been forged or are under negotiation. The imperatives of these trade arrangements and of WTO accession and membership are shaping policy and institutional reform throughout Asia and the pattern of growth in the region and beyond. Some sub-regional connections are also growing: strong trade flows with China, for example, are creating an economic growth corridor in the Mekong.

1.3 Linkages are also increasing politically, as the regional architecture evolves into a broader pan-Asian construct. China is continuing to look outward, India is looking to its east, and the East Asia Summit process is bringing together the ASEAN plus three (China, Japan and South Korea) states with India, New Zealand and Australia.

1.4 But the remarkable story of economic growth in Asia has to be seen in the context of the enormous challenges still remaining. Table One tells the story: growth is not uniform, with some 700 million people living on less than US\$1 a day and 1.9 billion living on less than US\$2 a day. Asia is also home to seven Least Developed Countries², and using a slightly different classification system, is home to 12 Low Income Countries.³ Tuberculosis – an ancient enemy of the poor – kills 700,000 people a year in

1 Goldman Sachs. Global Economic Paper Number 99. 'Dreaming with BRICS: The Path to 2050'. October 2003.

2 Least Developed Countries are defined by the United Nations using three criteria: income per capita of less than \$US750 per annum; weaknesses in human resource profile; and economic vulnerability. With these criteria, Asia is home to the following Least Developed Countries: Bangladesh, Bhutan, Cambodia, East Timor, Laos, Myanmar, and Nepal. The number rises to eight if Afghanistan is included in the definition of Asia.

3 Bangladesh, Bhutan, Burma, Cambodia, India, Indonesia, DPRK, Laos, Nepal, Pakistan, East Timor, and Vietnam. The number rises to 14 if Afghanistan is included in the definition of Asia.

Table 1: Selected indicators for countries in the Asia region

Country	Total population 2003 (millions)	Total expected population 2015 (millions)	Gross national income 2003 (billions US\$)	Gross national income per capita 2003 (US\$)	Share of population living on less than US\$2 day (%)	Share of children under five who are underweight (%)
Australia	19.90	21.9	436.50	21,950	n/a	0
Afghanistan	n/a	n/a	n/a	n/a	n/a	n/a
Bangladesh	138.10	166.0	55.00	400	82.8	52
Bhutan	0.87		0.55	630	n/a	n/a
Burma	49.40	55.7	n/a	n/a	n/a	n/a
Cambodia	13.40	16.4	4.10	300	77.7	45
China	1,288.40	1389.5	1,416.80	1,100	46.7	10
DPRK	22.60	24	n/a	n/a	n/a	28
India	1,064.40	1231.6	570.80	540	79.9	46.7
Indonesia	214.70	246.8	173.50	810	52.4	27
Laos	5.70	7.3	1.90	340	73.2	40
Malaysia	24.80	29.6	96.10	3,880	9.3	n/a
Maldives	0.29	n/a	0.69	2,350	n/a	n/a
Mongolia	2.50	2.9	1.20	480	74.9	13
Nepal	24.70	31.1	5.90	240	82.5	48
Pakistan	148.40	192.8	77.60	520	65.6	35
Philippines	81.50	98.2	87.80	1,080	46.4	n/a
Sri Lanka	19.20	21.5	17.80	930	50.7	n/a
Thailand	62.00	66.3	135.90	2,190	32.5	n/a
East Timor	0.87	n/a	0.37	460	n/a	43
Vietnam	81.30	92.4	38.80	480	n/a	34

Notes: n/a = data not available

Source: World Bank, World Development Indicators 2005

South-East Asia alone, and infects a further three million.⁴ Median fecal coliform levels in Asian rivers (a key indicator of health risk) are three times the world average and 50 times higher than the level recommended by the WHO.⁵

STATE STRENGTH, STATE WEAKNESS, AND UNEVEN INTERNAL GROWTH AND OTHER CHALLENGES

1.5 The region also faces the twin challenges of state strength and state weakness. Economic growth is

fuelling a potentially destabilising change in regional great power dynamics, while amplifying the stresses on the states left behind.

State strength

1.6 Regional stability in the next ten years will depend upon how the great power relationships – between the United States, Japan, China, India, and Russia – evolve, and how the region accommodates the economic and political rise of China and India.

4 HIV AIDS, Tuberculosis, Malaria. The Status and Impact of the Diseases. The Global Fund to Fight AIDS, Tuberculosis and Malaria. 2005. Page 32.

5 Environmental Challenges of Development in the East Asia and Pacific Region. World Bank.

1.7 China's rise and its relations with the United States, Japan and India will be of particular importance to the regional balance of power. United States-China relations will depend on the degree to which the United States seeks to remain engaged in the region and how it responds to the increasing economic, political and diplomatic influence of an ascendant China. China-Japan rivalry remains deep seated, and may increase further as China continues to rise and Japan moves to adopt a more active strategic posture.

1.8 The Asia and Pacific regions are home to the world's largest militaries and at least five nuclear powers. While interstate conflict in the next ten years is unlikely, there is a risk that the regional balance of power will fail, and interstate conflict ensues. Traditional flashpoints in the region include the Korean peninsula, the Taiwan Straits and Kashmir.

1.9 But new dimensions are being added to interstate relations by growing nationalism within some states, increasing pollution, and by growing rivalry for markets and access to natural resources, especially energy. In some instances these issues will breed cooperation, such as energy pipelines linking states, and the growth of regional and subregional bodies to oversee resource allocation and to mediate in disputes. But they could also breed competition and stoke tensions. The intensifying search for export markets and for secure sources of energy, for example, is already a key driver of China's and India's foreign policy. While the India-China relationship has been maturing economically and politically, scope still exists for competition in the over markets in South-East Asia and energy in Central Asia. Energy is also an increasing source of friction in the China-Japan relationship.

1.10 Fast economic growth has brought significant development and social challenges to the states that have most benefited from it. The environment is one such issue: China has 16 of the world's 20 most polluted cities, and underground water reserves are only a quarter of their level of 40 years ago as a result of urbanisation and inefficient and excessive

industrial use of water.⁶ China now has 52 river sections so contaminated they are not suitable even for irrigation.⁷

State weakness

1.11 Some states are gaining little benefit from the region's economic growth and the disparity in the performances of states looks set to grow starker over the coming years. Important parts of North-East Asian economies have by and large integrated into a globalised production chain. But all states, especially those in South-East Asia, also face the significant challenge over the coming decade of improving export competitiveness and moving up the value chain in light of the dramatic change in the economic landscape brought about by China and India's growth and export prowess. States such as Taiwan, South Korea, Thailand, and Vietnam are well placed to continue to benefit from the region's growth trajectory because they have demonstrated a capacity for rapid structural change in their economies.

1.12 Some states may not be able to adjust their economies quickly and deeply enough in response to the rise of China and India. Indonesia and the Philippines – home to more than 90 per cent of the population of South-East Asia – face challenges. As shown in Table Two, these countries already face deteriorating competitiveness across the board.

1.13 The slipping of Indonesia and the Philippines to last and second last rankings respectively on physical infrastructure is worrying, given the critical role of infrastructure in determining international competitiveness.

1.14 Indonesia's democratic elections last year went smoothly, and continued the trend of democratisation in the region. But Indonesia faces significant challenges, including weak institutions, separatist concerns, terrorism, and the pressing need for economic reform. The Philippines' trajectory has been resolutely negative for a number of years: it is beset with a fiscal crisis, weak governance, poor service delivery, and political instability.

6 *China 2001–2010: Political, Economic and Social Issues of Reform and Transformation*. FitzGerald, Davies and Tang. 2005.

7 *Connecting East Asia*. Page 22.

Table 2: Competitiveness rankings out of 60 countries

	2001	2002	2003	2004	2005
Philippines					
Economic performance	33	40	34	43	37
Government efficiency	34	35	32	38	42
Business efficiency	31	36	40	48	49
Infrastructure	42	43	47	56	59
Indonesia					
Economic Performance	40	37	42	51	55
Government efficiency	37	47	46	56	54
Business efficiency	43	44	49	57	58
Infrastructure	46	48	48	59	60

Source: World Competitiveness Yearbook, 2004, and ADB⁸

1.15 Several fragile states in Asia lack the human capacity, and physical, social and institutional infrastructure to capitalise on regional growth and risk lagging ever further behind. A vicious cycle exists in fragile states, in which weak governance and institutions, poor service delivery, a stalled economy, and instability combine to further corrode governance and institutions, reduce service delivery, erode state legitimacy, breed greater instability, increase the numbers of poor, drive investors further away, and drive the economy further down. This cycle is even more pernicious in conflict or post-conflict environments.

1.16 Cambodia, East Timor, Laos, and Nepal are among the poorest countries in the world, with weak governance, poor human development indicators and a chronic lack of human capacity due in part to their history of conflict. Cambodia, Laos and Nepal might benefit from their geography: Cambodia and Laos are in the Mekong growth corridor and Nepal is next to India. But they might also remain fragile and unstable and therefore havens for transnational crime. Cambodia also faces immediate challenges in adjusting to China's

rapid expansion of clothing and garment exports in Cambodia's traditional export markets.

1.17 East Timor has one of the highest fertility rates in the world, with an average of nearly eight children per woman. Large numbers of young men have few job prospects: this fuels urban drift, social instability and crime, and can also lead to political instability as disaffected youth rally around any cause and any demagogue. Other states, including Cambodia and the Philippines, have similarly pronounced youth bulges, with population growth rates outstripping economic growth rates over the medium to long term.

1.18 North Korea and Burma have a different pathology: they have strong regimes and strong elements of the state apparatus combined with a closed and profoundly weak economy, weak governance, and weak society. The collapse of the apparatus of state power in either of these states could mean they lurch into acute crisis, with significant economic, humanitarian and security consequences including potentially sizeable refugee flows.⁹

⁸ Draft Regional Cooperation Strategy Program: Southeast Asia Region. ADB. March 2005.

⁹ That risk, however, is not an argument for turning a blind eye to such authoritarian and closed regimes or preferring the status quo. As noted in one recent study looking at the link between poorly governed states and United States national security: 'Local elites cannot be evaded or wished away... we know from decades of painful experience that benign neglect, indulgence, or isolation seldom loosen these groups' hold on power'. (Reference: On the Brink: Weak States and US National Security: A Report of the Commission for Weak States and US National Security. Centre for Global Development. May 2004). Having said that, it is also clear that finding entry points to promote reform in such countries is difficult.

1.19 Managing state weakness is a key issue facing the region in the next decade. Instability within fragile states can radiate out into the region in the form of refugees, violence, pandemics, and transnational crime. The security, economic and humanitarian impact would increase dramatically if they collapse.

Uneven internal growth and other challenges

1.20 Growth has not only been uneven among the states throughout the region. States such as China, India and Vietnam are experiencing starkly uneven growth internally. Uneven internal economic growth and the phenomenon of jobless growth are contributing to urban drift throughout the region as large numbers move to the cities in search of work. By 2020, two billion people – half of Asia's population – will live in urban areas with about half of those in slums. Eighteen of the world's 27 megacities will be in Asia.¹⁰

1.21 The World Bank notes that economic growth in China no longer has a dramatic impact on reducing poverty: 'Most of the remaining poor are cut off from the dynamic market economy for one reason or another: they are in remote locations far from markets and/or ethnic minorities not well integrated into society and/or disabled'.¹¹ This has led to a sharp rise in rural and urban inequality in recent years.

1.22 These trends have important implications for internal social and political stability, and could even derail growth in these states. There are significant interactions between large numbers of unemployed males and the potential for social and political violence, and security more generally. One study¹² notes that 'neither poverty alone nor worsening economic trends predictably produce acute conflict. Nor are economic conditions and trends by themselves useful in explaining failed states. However a disproportionately large youth cohort

correlates with the potential for violence, especially if the youth have frustrated aspirations through *some* level of education but *limited* employment opportunities. Development agencies therefore need to note that education *per se* is not always a force for stability.¹³ This is important, since Asia has an estimated 38 million people aged 15 to 24 who are unemployed and this trend is worsening.¹⁴

1.23 Asia also faces the demographic challenge of ageing and the prospect of old age poverty. The United Nations notes that more than half of the world's population already live in Asia and this will increase to 63 per cent by 2050; that the number of people aged 60 and over in China, India and Indonesia alone will increase from 222 million in 2000 to 831 million in 2050; and that population dynamics have created several gender related issues which could worsen the welfare situation, particularly of women for countries in Asia.¹⁵ The challenge of an ageing population is acute in Japan, but also will occur in the next half century in China, Sri Lanka, Thailand, and several North and Central Asian states still developing.¹⁶ Within the next decade or two, the demographic imperatives of an ageing population in some states and youth bulges in others might lead to political movement in the region on the issue of labour mobility.

1.24 Uneven access to state resources, service delivery, economic opportunity, and poor governance – combined with sectarian tensions – have given rise to internal conflicts (for example, in the Philippines). The state has little reach into parts of the Philippines, particularly in the south, and this political vacuum has been filled by both Muslim and Communist insurgents. Localised violence in parts of the region looks set to continue in the next decade.

10 *Megacities*, Asian Development Bank Seminar Series. Megacities are defined as having a population of ten million or more people.

11 *Improving the Efficiency of China's Growth is Important for the Whole World*. David Dollar. World Bank.

12 *Youth and Conflict: A Toolkit for Intervention*. US Agency for International Development, Office of Conflict Management and Mitigation.

13 *Youth and Conflict*. Page 6.

14 *Economic and Social Survey of Asia and the Pacific 2005*. Page 41.

15 *Economic and Social Survey of Asia and the Pacific 2005*. Pages 219 and 223.

16 *Economic and Social Survey of Asia and the Pacific 2005*. Page 224.

TRANSBORDER THREATS

1.25 The increased movement of goods, services and people is exacerbating transborder security threats, including transnational crime and terrorism, pandemics and natural resource depletion.

1.26 Organised crime such as gambling, drugs and the sex industry is increasing along corridors of trade and economic growth. Transnational criminal networks are exploiting the increasing disparity between and within states. As some prospering states improve border controls and security infrastructure, transnational criminal networks move to states with weaker internal security. Fragile states can thereby become centres of operation for illicit activities such as the drug trade, people and sex trafficking, money laundering, and identity fraud. Laos, for example, with its porous borders shared with five neighbours, is considered to be at growing risk of becoming a destination for transnational crime.

1.27 Terrorist networks can also use fragile states with porous borders as bases in which to hide, train or from which to launch attacks against other states and interests in the region. Cambodia, for example, is an increasingly attractive haven for transnational criminal operatives as neighbours such as Thailand have tightened their border security and cracked down on crime. Cambodia has a growing drug trade and the terrorist operative Hambali spent several months in the state a couple of years ago.

1.28 Linkages with international terrorism have increased in South-East Asia. Al Qaeda has links with the regional terrorist network Jemaah Islamiyah and these networks are taking advantage of state weakness, sectarian violence and separatist movements born of local grievances and have formed links with local militant organisations. The separatist conflict in the Southern Philippines, for example, has acquired an international overlay, as the terrorist network Jemaah Islamiyah has exploited the instability, deprivation and extremely weak state apparatus in that part of the state. Terrorist operatives have moved across porous borders in the region to form links with local insurgent groups the Moro Islamic Liberation Front (MILF) and Abu Sayyaf.

1.29 Increasing interdependence will also likely increase the relevance of the Central Asian Republics

to the rest of Asia. The republics are characterised by stalled economies, social and political instability, links with jihadi extremists, and bountiful supplies of energy. This makes them not only a possible theatre for great-power competition, but also a potential exporter of instability in the form of transnational crime (including weapons and the drug trade) and militant extremism, particularly into the restive, Muslim-majority, and energy rich Chinese province of Xinjiang.

1.30 Environmental damage and natural resource depletion are also transborder by-products of rapid economic growth in the region. Concerns about increasing pollution and resource depletion will drive the growth of nuclear energy and a demand for clean energy. Water will be a significant issue in the medium term, and will promote cooperation and competition. The Mekong River Commission is an example of efforts at cooperation among the Mekong states Thailand, Laos, Cambodia, and Vietnam (with Burma and China as dialogue partners) to discuss the sustainable management of water resources. But water tensions exist already, for example, between China and Pakistan, Bhutan, and Nepal, and in Central Asia, as well as in the Mekong.

1.31 HIV/AIDS and other pandemics are clearly important transborder issues in Asia: paragraph 4.6 onwards.

POSSIBLE SHOCKS

1.32 The above is the likely context in which the aid program will operate in Asia in the medium term. It is important, however, to be cautious and modest about predicting the likely strategic lay of the land. Economic growth in the region and the other trends outlined above might stall or cease as shocks emerge. One of the most significant would be if a nuclear terrorist attack occurs in Asia Pacific. Such an attack – for instance in the United States – would have a major impact on global stability and the global economy.

1.33 Another potential shock would be if China's economic growth were to stall – for example as a result of a banking or financial crisis, triggered by bankruptcy of large, unviable, state owned enterprises. Alternatively – or maybe as a result of stalled growth - there may be political crises and

internal turmoil. This is not implausible if social pressures arising from the disparity in wealth and internal pressures for political reform grow in China. An abrupt halt to China's now seemingly inexorable rise would have significant consequences – first and foremost economic – for the region.

1.34 India's growth might also stall. There are varying schools of thought on the relative future performances of China and India. One school maintains that while China's growth is the more dramatic, it is more vulnerable because of its political system and other internal pressures, whereas India's fundamentals, including its democratic process, are more sound. Another school holds that the Chinese system has proved itself reasonably agile and able to calibrate the political response required at all stages of its growth, which puts it in a better position than does the more lumbering political system of India. Both views are plausible, and either might come to pass. Of course, China's and India's trajectories are not binary: both could stall or rise.

1.35 Asia is not necessarily more exposed, or vulnerable, to exogenous shocks than other regions. Indeed, evidence suggests the robust and flexible economies of East Asia are quite well placed in terms of shocks.¹⁷ On the other hand, when shocks occur, they can have a major impact on growth and poverty. The 1997 Asian financial crisis is estimated to have made 30 million people in Asia suddenly very poor and, according to the ADB, the Boxing Day Tsunami meant two million additional people joined the ranks of the 'new poor'.¹⁸ Aid can make a big difference in the severity, cost and duration of such shocks. The UN notes that for every dollar spent on disaster reduction about US\$10 is saved by limiting the needs of subsequent relief, but research also shows that of all aid received for disasters only two per cent goes on prevention.

AUSTRALIA'S NATIONAL INTEREST CONSIDERATIONS

1.36 Events in Asia matter to Australia. Australia is part of the region and cannot insulate itself from the

challenges the region faces: ever-increasing regional interdependence means these challenges directly affect Australia. A sharp deterioration in great power relations in Asia or a crisis on the Korean peninsula, for example, could destabilise the region, threaten prosperity and have significant security and economic implications for Australia. Fragile states can also destabilise the broader region, as refugees, violence, and transnational crime (such as people smuggling and trafficking), drug smuggling, and gun running spread across porous borders. Terrorist operatives can use weak states as bases in which to train and from which to attack other states in the region, including potentially Australia. Australia has of course already felt the brunt of terrorism in the region, with the Bali bombing in October 2002 that killed 202 people including 88 Australians, and the bombing outside the Australian Embassy in Jakarta in September 2004, with 11 victims. And pandemics in the region and environmental damage have consequences for Australia.

1.37 Our prosperity and security are inextricably bound up with the prosperity and security of Asia. Indonesia, East Timor and the Philippines most directly engage Australia's interests: they are nearest to Australia of the states in Asia and their instability has a great capacity to affect Australia. But it is also in Australia's interests that the rest of Asia prosper and be secure.

1.38 So what role can the aid program play within a whole-of-government approach to promote prosperity and stability in the region? This role needs to be grounded in a realistic assessment – as to what an aid program can and cannot achieve. Aid will have little bearing on most aspects of great power relationships in Asia Pacific, but it can help find further opportunities for economic growth and shape the policy environment to drive further growth. It can also have an impact on state weakness and uneven growth among and within states, and help minimise possible threats such as transnational crime, terrorism, financial shocks, pandemics, and the effects of resource depletion and environmental damage.

17 The World Bank notes that 'what is remarkable about East Asia is not that it experienced a crisis in 1997 but that it experienced so few crises over the preceding decades. By and large, developing countries have one year of negative per capita growth roughly once every three years. In East Asia the average is half that rate. Korea has had only three years of negative per capita growth since 1961.' See *Economic Growth in the 1990s – Learning from a Decade of Reform*. World Bank. 2005. Page 4.

18 *Economic and Social Survey of Asia and the Pacific 2005: Dealing with Shocks*. ESCAP. Page 38.

The response: Making good development choices

2.1 The preceding section makes two points. First, strategic issues, growth and development are inextricably intertwined in Asia. Second, how well countries in the region manage these challenges has direct consequences for themselves, the region and Australia.

2.2 How Australia responds to these challenges is important. Making good choices is critical, especially in a region as large and varied as Asia. Aid cannot DO everything. Nor should it. This paper therefore recommends four principles to filter and prioritise Australia's aid response to the strategic challenges of Asia over the coming decade.

2.3 The first principle is that preference should be given to activities that contribute to sustained, high quality, growth in the region. Sustained high quality growth¹⁹ is a precondition for prosperity, stability and security, and will do more than anything else to reduce poverty. As noted in a recent World Bank study of 14 countries: 'The pace of overall economic growth is the main factor that determines how quickly poverty declines' and that, on average, a one per cent increase in GDP per capita reduced poverty by 1.7 per cent.²⁰

2.4 The second principle is that aid interventions in Asia needs to align with Australia's national interests. These interests are increasingly intertwined with the strategic and development challenges facing Asia by virtue of Australia's location and increasing economic integration in the region. Australian aid can complement the broad and constructive engagement the country has with Asia, including whole-of-government engagement, and broader economic integration.

2.5 The third principle is that aid should be increasingly strategic and leverage up its impact if it is to be effective over the coming decade. This is particularly true in a region as large and varied as Asia, where even total aid – let alone Australian aid – is relatively small (latest figures show, for example, that aid to Indonesia represents just 0.8 per cent of Indonesia's economy, or US\$6 per capita per year. The relative size of aid in other countries of Asia is similarly small).²¹ Australian aid to Asia should increasingly focus on what it does best and where it can demonstrate comparative advantage.²²

19 There are various definitions of 'quality' or 'pro-poor growth'. See for example *The Quality of Growth*. World Bank Publication. September 2000 and *What is Pro-Poor Growth and why do we need to know?* DFID Pro-Poor Growth Briefing Note 1. February 2004. In essence, this paper uses the term 'quality growth' to mean growth that is environmentally and socially sustainable and reduces poverty.

20 *Pro-Poor Growth in the 1990s: Lessons and Insights from 14 Countries*. World Bank (and others). June 2005.

21 *World Development Indicators 2004*. World Bank. Page 335. Similarly, ODA accounts for approximately just one per cent of gross investment in low and middle income countries in East Asia generally; 0.1 per cent of China's economy; and 0.7 per cent of the Philippine's economy. It does, however, represent 17.3 per cent of the GNI of Lao PDR; and 12.7 per cent of Cambodia's GNI.

22 The usual tests for good aid effectiveness should, of course, continue to apply over the coming decade. Good development is essentially about reform and change and aid programs should, at all times, support that process. Aid should not substitute for partner government's own efforts nor should it substitute for the private sector, support reforms that would have happened anyway, or support reforms that will never be sustained because of intractable vested interests. The environment for aid is changing rapidly and aid modalities need to change too.

2.6 The fourth principle is that, while being strategic and focused, aid should also be flexible and responsive to the rapidly changing environment of Asia. Many major events that now characterise the region were not and could not have been predicted ten years ago.²³ The same applies now.

2.7 Using those four principles to screen the wide array of development challenges in Asia produces a package of recommendations and options for Government. These can be grouped under three broad headings: the challenges Australia should focus on in the coming decade; changed modalities for Australian aid; and changed country and regional priorities.

²³ See separate paper entitled *If the White Paper had been written in August 1995*.

Recommendations on *what* Australia should do

3.1 The recommendations are options: not all could or should be applied in all cases or all countries. It is worth noting that many recommendations overlap and reinforce each other. Improved domestic economic governance – for example through more transparent and predictable application of domestic commercial law – can improve prospects for trade, foreign investment, and broader economic integration. This, in turn, can help sustain and lock in the pace of economic governance reforms.

CONSOLIDATION OF EXISTING EFFORTS

3.2 Australia should continue and consolidate its existing efforts in areas central to driving growth and reform in Asia.

Economic governance

3.3 In practice, this means Australia should continue its focus on **economic governance**. International literature and experience demonstrate that good governance – especially economic governance – is at the core of quality economic growth. Evidence for this is overwhelming, including for Asia. One example emerges from the latest World Bank research on growth which reports that:

A successful pro poor growth strategy should have, at its core, measures to achieve sustained and rapid economic growth. These include macroeconomic stability, well defined property rights, a good investment climate, an attractive incentive framework, well functioning factor markets, and broad access to infrastructure and education.²⁴

3.4 Australia has worked to support several – but not necessarily all – of those drivers of pro poor growth. For example, Australia has a very good record of working in areas of broad macroeconomic stability, public sector financial management and land tenure and property rights in Asia. But if sustained and sustainable economic growth was to be the primary lens through which we maximise the impact of Australian aid, the time may be approaching where we shift the current emphasis on civil service and public administration reform as such and give more explicit attention to reforms that improve the **environment for private sector growth**. There are now several effective, innovative examples of how aid agencies can achieve high development impact in promoting, or working with, the private sector that could serve as a model, including the World Bank's *Doing Business* approach and innovative work on what is termed 'output based aid'.²⁵

24 *Pro-Poor Growth in the 1990s: Lessons and Insights from 14 Countries*. Page 2.

25 See *Doing Business in 2005: Removing Obstacles to Growth*. World Bank. For output based aid see www.gpoa.org

Trade and regional economic integration

3.5 Australia should also continue and its efforts with **trade and regional economic integration**.

The justification for this is clear. First, trade and economic integration is highly correlated with growth.²⁶ Second, the evidence²⁷ suggests that the dynamic growth of China and India over the coming decade will be one of the single biggest drivers of the level and pattern of growth and development in the region - there are major opportunities but also major risks. Third, Australia has fundamental national and broad whole-of-government interests at stake in the trade and economic integration path Asia takes over the coming decade. Fourth, 'trade is an opportunity, not a guarantee'²⁸ for quality growth so there may be slippages and missed opportunities. Countries can easily fail to capture the economic and developmental benefits of trade. The public good nature of well designed aid means it can help respond to market and government failures and be a catalyst for reform.

3.6 Australia has a successful record of facilitating trade and economic integration in the region, including aid funded support for China's accession to the WTO. New and significant opportunities are arising for aid to play a catalytic role in deepening economic integration in the region. Many of these initiatives have a major focus on economic growth and integration, and aid may therefore well have an important – albeit supporting – role to play.

3.7 However the sheer number of regional and subregional initiatives – see for example paragraph 5.11 below – means that aid interventions need to be selective and very strategic. Aid is likely to be most valued and effective in those regional and subregional institutions which drive the process of domestic internal reform for countries in the region; involve institutional or regulatory reform; or involve capacity building. The proposed greater use of applied research, 'ideas' and evaluation of reforms (paragraph 5.5) would also complement these activities. Australia could work with the ADB, which

is clearly giving much higher priority to the regional economic integration.

Rural development

3.8 **Rural development** will remain a critical driver of growth for many countries in the region over the coming decade. Poverty will be concentrated in the rural sector through to 2025. World Bank analysis shows that:

increasing agricultural productivity is the most efficient path for many countries to reduce poverty and inequality; that agricultural growth has been more pro poor than industrial growth in Indian and in Indonesia; and that in China primary sector growth has about four times the impact on poverty reduction as secondary or tertiary sector growth. Rural and especially agricultural growth reduced inequality not only in rural areas but also between rural and urban areas.²⁹

3.9 Good quality rural development is also a strong driver of employment opportunities for youth in developing countries, food security and protecting the natural resource base. This is particularly true in countries like East Timor where more than 80 per cent of the population is rural and the vast majority poor, but it is also in many other countries of Asia.

3.10 Australia has a great deal to offer here. The benefits of Australia's agriculture, forestry and fisheries research and development continue to raise productivity and improve the sustainability of farming systems in much of Asia. Australia's knowledge in water and river basin management and the prevention and treatment of soil salinity is widely recognised and adopted. Expertise in agri-business development and management, trade policy and practice, quarantine and phyto-sanitary standards and regulation, and rural finance are also widely accessed by Asian governments and the private sector. The coming decade is also likely to see rapid developments in genetic based research applications

26 *Globalisation, Growth and Poverty – Building an Inclusive World Economy*. World Bank. 2001.

27 *Asia and China: Growing Together?* Keynote Speech by President of the ADB, H Kuroda, at the Institute for International Economics. 23 June 2005. As one example: China's imports from Asia have risen by an average annual rate of 31 per cent over the period 2001 to 2003 in US dollar terms.

28 *Economic Growth in the 1990s: Learning from a Decade of Reform*. World Bank. 2005..

29 *Pro Poor Growth in the 1990s*. Op cit. Page 42.

in agriculture. Australia would be well placed to support work here.

SIGNIFICANT SCALING UP

4.1 Australia should also significantly scale up its existing engagement in those sectors, or forms of aid, which will increasingly drive growth and reform.

SCHOLARSHIPS FOR LEADERSHIP AND REFORM

4.2 One specific recommendation is to scale up **Australian Development Scholarships as a vehicle for the next generation of leadership and reform in Asia**. The justification for this is clear. The dramatic changes expected in a dynamic Asia in the coming decade require continued reform – for the fast growing and reform minded countries of East and South Asia as well as the weaker and fragile states of Asia. But reform for reform to happen it needs reformers.

4.3 Many in Asia argue that the most effective and durable reform comes from having a critical mass of well trained and capable local leaders, who have exposure to international practices in positions of authority to make their own systems adapt and work better. Such reform from within is preferred to externally provided technical assistance from consultants. A constant theme of stakeholders in the region, including from multilateral banks, is that Australian Development Scholarships were possibly the most effective form of aid Australia delivered and that they should be expanded and made even more effective. Scholarships not only build capacity and the supply side of reform, they also build the *demand* side of reform, especially if they involve a critical mass of reformers.

4.4 Of course, scholarships do not automatically or always produce leaders and reform. Indeed, poorly conceived scholarship programs can become a tool of patronage that just help perpetuate a self-serving and closed elite that holds onto power and blocks reform. And development scholarships from Australia should never substitute for scholars who would have come here under privately funded sources. It is also important that development

BOX ONE: EDUCATION, SCHOLARSHIPS, LEADERSHIP, AND AID IN FRAGILE STATES.

‘The typical Low Income Country Under Stress (LICUS) not only has a small share of its population with above primary education, it also has a small population. Hence, the pool of educated people may well be too small either to generate or to manage the radical adaptations that are necessary in the transformation from LICUS status...Aid spent on providing a cadre of well educated people has an expected pay off far in excess of its likely cost.’

Development Effectiveness in Fragile States: Spillovers and Turnarounds. Lisa Chauvet and Paul Collier. Mimeo 2004.

scholars return to their countries to contribute to the growth and reform process.

4.5 It is therefore important that Australia continue to look critically at the way it manages its scholarship program to ensure it maintains the standards of developmental effectiveness, integrity, efficiency, and accountability. Australia has an established and effective record of scholarships for development, dating back to the Colombo Plan. More, however, can be done to improve the impact of scholarships and ensure they meet the contemporary development needs of modern Asia. For example, scholarships could be better targeted in numbers and focus to meet the leadership, reform and capacity needs of fragile states. More can be achieved to ensure the impact of returning scholars is not diluted by perverse institutional incentives operating in the country to which they return. The people-to-people links that are a feature of scholarships could be better matched and consolidated with institutional-to-institutional links. And more progress could be made in building and supporting a professionally and developmentally oriented alumni of scholars.

4.6 It is also important to recognise that the largest contribution to growth and development will come, ultimately and quite properly, from the quality and effectiveness of a developing country’s national system of education, from the basic education system through to tertiary and adult education. Much of this drive and effort has to come from the developing

country itself, because the challenges that need to be addressed are system-wide. But development agencies can and should support the reform of education systems (see also paragraph 4.15).

4.7 Significant scaling up of Australian aid could also occur in **health**. The justification for this is strong. Good health is an important development objective in its own right, is a strong contributing factor to economic growth, and has direct links with poverty reduction.

Pandemics

4.8 There is a strong case for scaling up Australian assistance to combat **pandemics**. Pandemics have large human, social and economic costs and can undermine development (see Box Two). Pandemics also directly affect Australian national interests by imposing potentially large health, social and economic costs on Australia. A significantly scaled up aid response is also warranted because of the strength of well- designed aid when public good arguments³⁰ are involved in combating pandemics.

4.9 **HIV/AIDS** is probably the most obvious pandemic challenge in the region. Given its importance a separate paper on HIV/AIDS was commissioned for this White Paper process. However the following points are highlighted with respect to Asia. First, the path of HIV/AIDS in Asia will determine the global situation. As noted by the World Bank:

With almost half the world's population, Asia will determine the future of the HIV/AIDS pandemic. If prevalence rates in China, Indonesia, and India increase to numbers similar to those seen in Thailand and Cambodia, the rate of HIV/AIDS would double globally. Such growth would be devastating for individuals – and for the region's health systems, economies, and social fabric.³¹

4.10 Second, Asia faces important challenges.

Estimates of the number of people living with HIV in East Asia grew by almost 50 per cent between 2002 and 2004 – one of the fastest growing AIDS epidemics in the world.³² And worrying situations are likely to develop close to Australia over the coming decade. The latest UNAIDS Epidemic Update notes that HIV prevalence among sex workers in parts of the eastern most Indonesian province of Papua had reached 17 per cent, more than five times the national average for Indonesian sex workers. That same report shows that nearly six out of ten sex workers in East Timor have never heard of AIDS, four out of ten do not recognise a condom when shown one, and zero out of ten consistently use condoms with their clients. The concurrence of poverty, fragile states, poor public health systems, and heroin and drug trafficking is a particular challenge in parts of Asia.

4.11 Third, there are some important positive situations. Countries such as Bangladesh and Phillipines are still seeing low levels of HIV prevalence, even among people at high risk of exposure to HIV, and have significant opportunities to avoid serious outbreaks. Thailand and Cambodia have been able to reduce prevalence rates.³³

4.12 **Newly emerging pandemics** such as SARS can also have major health, financial, economic, and political repercussions in the region and beyond (Box Two). The link to zoonotic diseases appears particularly close in Asia. Bioterrorism is also a risk.

4.13 A major influenza epidemic in the coming decade would have substantial health, development, and economic effects in the region and beyond. The Director of the Centre for Infectious Disease Research and Policy, and Associate Director of the United States Department of Homeland Security, notes:

30 In brief, it may not just be lack of a critical mass of scientific and public health management capacity that constrains developing countries from responding to pandemics – although they may well be factors. Rather, individual developing countries may not have a strong *incentive* to invest scarce resources in fighting pandemics if they believe the actions – or inactions – of neighbouring countries will drive the course of the epidemic anyway, or if there is a fear neighbours will simply become free riders on any solution. Well designed and coordinated aid programs can compensate for these constraints.

31 *Addressing HIV/AIDS in East Asia and the Pacific*. Health Nutrition and Population Series. The World Bank. 2004. Page 1.

32 *Global Fund*. Op cit. Page 11.

33 *Global Fund*. Op cit. Page 20. And the example of Cambodia where HIV prevalence has declined from a high of 3.3 per cent of the adult population to 1.9 per cent shows that impact is possible if governments recognise the problem and effective action is well targeted.

BOX TWO: THE EFFECTS OF SARS

Starting in rural China, SARS spread to five countries within 24 hours and to 30 countries on six continents within several months. One infected person traveled by plane from Hong Kong to Toronto: 438 people were later infected in Canada; 43 died; the Canadian Tourist Commission estimated the epidemic cost the nation's economy \$US419 million; and the Health Minister estimated SARS cost Ontario's health care system about \$US763 million. The economic impact of the six-month SARS epidemic on Asia Pacific is estimated at about \$US40 billion.

SARS also had substantial political consequences. Chinese Premier Wen Jiabao said in a Cabinet Meeting on the epidemic that 'the health and security of the people, overall state of reform, development, and stability, and China's national interest and image are at stake.'

Preparing for the Next Pandemic
M Osterholm in Foreign Affairs,
July–August 2005

Consider this sobering information: the most recent influenza pandemic of 1968–9 emerged in China when its population was 790 million; today it is 1.3 billion. In 1968 the number of pigs in China was 5.2 million; today it is 508 million. The number of poultry in China in 1968 was 12.3 million; today it is 13 billion. Changes in other Asian countries are similar. Given these developments, as well as the exponential growth in foreign travel over the past 50 years, an influenza pandemic could be more devastating than ever before...The reality of a coming pandemic...cannot be avoided. Only its impact can be lessened.³⁴

4.14 An illustrative model for what could be done to respond to a major pandemic is canvassed in Box Three.

BOX THREE: RESPONDING TO A MAJOR PANDEMIC IN THE REGION

Many believe that a major pandemic – for example of influenza – is inevitable in the region and would have major health, social and economic consequences.

What can Australia usefully do now? A coordinated whole-of-government response, including the aid program, could save lives and avert huge economic losses. Specific initiatives would involve significantly strengthening disease surveillance in countries in the region so that outbreaks can be detected and responses launched earlier: countries cannot be strategic in the absence of good data and that requires improved surveillance. It also requires improved laboratory diagnostic capacity and training and equipping of national and regional response teams. Reinforcing health control measures at national borders is critical to reducing transboundary spread of disease. Support to international collaborative research, including efforts to develop vaccines, is also important to finding more sustainable solutions.

4.15 While a new focus is needed on pandemics, **continued attention is also needed for endemic and communicable diseases.** Malaria continues to be a major concern. One third of the world's TB cases are found in South-East Asia: nearly three million new cases and 700,000 deaths per year.³⁵ Multiple drug resistance and HIV/AIDS threaten to undermine gains made in TB control and tend to disproportionately affect the poorest and most vulnerable. After an absence of ten years, polio has re-emerged in neighbouring Indonesia, with 219 cases being reported in Java and Sumatra.³⁶

³⁴ Michael Osterholm, Director of the Centre for Infectious Disease Research and Policy, in Foreign Affairs. Op cit.

³⁵ *Global Fund Report*. Op cit. Page 32.

³⁶ *Polio vaccine scheme needs \$7 million in The Australian*. July 9–10 and August 16 2005.

4.16 For strategic gains to be made in health there needs to be increased engagement with **health system development**.³⁷ How governments in the region organise their financial and human resources to deliver public health is the strategic driver of longer term outcomes. Regional responses in Asia rest in many respects on the quality and depth of national responses and national capacities and there are significant weaknesses and gaps in Asia. Indeed, there are huge unmet health needs in Asia: an estimated US\$30 to US\$40 per capita is needed annually to finance the minimum health service package in Asia, but Bangladesh, Cambodia, Lao PDR, Pakistan, Mongolia, and Vietnam all spend less than US\$10 per capita. Scaled up assistance that address the root causes of *systems* failure would have widespread and strategic impact. It would also help address currently neglected and underfunded priorities including maternal and child health care in Asia.

4.17 Similar opportunities for significantly scaled up, and strategically wide impact, apply in the case of **education**. Again, the rationale is clear: like health, education is a benefit in its own right that creates a foundation for economic growth and has spill over benefits for health. Scholarships to study in Australia are the first pillar in human capacity development assistance. The second pillar is support for reform and strengthening of the education system itself within the country. Mass education makes an important contribution to nation building and stability by enabling people to engage with law and justice systems and democratic processes. Education – including science, higher and technical vocational education – will be an increasingly important determinant in Asia of a country's capacity to engage and compete in a global economy over the coming decade. Improving the access and strengthening the quality and rigour of higher and tertiary education can help produce the next generation of public and private sector leaders. Support for higher and tertiary education is particularly important in

fragile states, in which a lack of human capacity constrains economic growth, good governance through mismanagement and problems with policy implementation, and development more broadly. Education will also be an important part of the response to growing inequality between and within countries in the region, and between genders. Girls' education has been found to be one of the most effective and durable forms of aid investment possible.

4.18 There are significant, specific opportunities for larger scale initiatives in education at the specific country level. These relate to basic, higher and technical/vocational education and capacity building in East Timor, education systems reform in the southern Philippines (paragraphs 6.7 and 6.8), the option of a very large and bold initiative involving education, and girls' education across East and South Asia (paragraph 6.22).

NEW AREAS FOR AUSTRALIAN ENGAGEMENT

Physical infrastructure

4.19 With some notable exceptions³⁸ Australia has not concentrated on **physical infrastructure** in its aid program. However if Australia wishes to be engaged in the main drivers of future economic growth in Asia over the coming decade, then physical infrastructure should be looked at again. The evidence is clear: infrastructure bottlenecks are likely to choke off growth in Asia unless there is major change. One major recent study finds that East Asia alone has resourcing needs in infrastructure of US\$200 billion per year over each of the next five years: a total of one trillion dollars.³⁹ It is also clear that much of the multilateral – and even bilateral – aid flows to the region will GO TO INFRASTRUCTURE. It is not in Australia's interests to be passive onlookers of such large flows, if only because the country is a shareholder in multilateral

37 It is not always clear what sort of health systems countries are trying to build with their own resources and external aid. Sustainable financing of health care (with an appropriate public/private mix); human resource planning, development and management; and health commodity procurement and management, are key building blocks. Deficiencies in these areas are crippling health systems rather than technical aspects of addressing specific diseases. Expanding criminal activity in the manufacture and distribution of counterfeit pharmaceutical products is one example of an issue requiring regional collaboration that extends beyond the health sector.

38 The My Thuan and Friendship bridges; post Tsunami Indonesia; some major infrastructure investments in the Philippines; and some large mixed credit activities in the 1980s and early 1990s, including significant investments in rural bridges in Indonesia. If water and sanitation is classified as infrastructure, then significant investments have occurred in this sector.

39 *Connecting East Asia*.

development banks and should be intelligently engaged in their core business.

4.20 Australia is unlikely to be a dominant funder of infrastructure in Asia – the financial costs are large and it is not necessarily the most appropriate use of grant aid. But there are opportunities for innovative engagement in this sector where Australia can help shape and direct the much larger investments flowing in which will shape growth and development in the region. For example, transport and growth corridors are vectors for HIV/AIDS transmissions – both at the construction phase and after completion – and Australia has recognised expertise, comparative advantage and interests in reducing HIV/AIDS transmission.

4.21 Australia has also demonstrated expertise in the economics and broader development impact of infrastructure: analytical work on the My Thuan Bridge, for example, has been used as a model by other bilateral funders of infrastructure in the region. Economic governance in infrastructure is also key: up to 30 per cent of investments in infrastructure are lost to corruption and poor governance,⁴⁰ while Australia has good systems for improving the efficiency, accountability and value for money of large scale investments. Finally, and importantly, construction and maintenance of key infrastructure such as roads is a major opportunity for generating long-term employment – especially among the poor and unemployed – in ways that can simultaneously reduce the import demand for capital equipment by up to 30 per cent.

Resources, especially clean energy

4.22 Australian aid should also be directed at another new sector: **resources, especially secure sources of clean energy and more efficient use of energy resources**. The rationale is clear. First, the sheer size and scale of resource use in Asia over the coming decade is strategically important in its own right, driving everything from economic

growth to environment and climate change. Energy consumption in China, for example, doubled between 1980 and 2000, and China is likely to displace the United States as the biggest energy user by 2050.⁴¹ Between 1990 and 2025 China's total carbon emissions are projected to rise by more than the combined increase for the United States, Western Europe and Japan.⁴² Much the same could be said for South Asia.

4.23 It is not just the magnitudes that demand attention. The efficiency and cleanliness of resource use do too. China, for example, requires about three times as much energy as the United States to produce US\$1 of economic output and emits nearly four times as much carbon dioxide per dollar of economic activity as the United States.

4.24 Secure access to energy has become a national security issue for many states in Asia and nuclear energy is increasingly seen as the answer by some. According to the World Nuclear Association, for example, China plans to build 27 nuclear plants to boost nuclear energy four-fold by 2020, and India intends to build up to 24 reactors over a similar period.⁴³

4.25 In short, access to clean energy and its more efficient use is a major strategic issue affecting the pace and quality of economic growth and development in the region. Australia has significant expertise in promoting clean energy, is a major exporter of energy (as well as holding the second largest reserves in the world of uranium), and has a direct interest in avoiding greenhouse gas induced climate change or environmental damage in the region through effects such as acid rain.

4.26 This will inevitably involve a whole-of-government response from Australia. Within that response, opportunities for significantly increased Australian aid engagement in this strategically important sector could include much greater and more specific engagement with the ADB

40 *Connecting East Asia*. Page 117.

41 *China Human Development Report 2002 – Making Green Development a Choice*. UNDP and Stockholm Environment Institute. Oxford University Press. Page 55.

42 'Coal Reliant China clouds environmental outlook'. *The Australian Financial Review*. 8 July 2005. Page 81. The article cites the Energy Information Administration as the source of the estimate.

43 'Glowing Outlook for Uranium' in the *Australian Financial Review*. 8 July 2005. Page 67.

and World Bank policy and lending operations in energy (paragraph 5.3) and/or a large long-term pipeline of development scholarships aligned with institution to institution links (paragraph 4.2). The establishment of the Asia Pacific Partnership for Clean Development and Climate is timely and a welcome opportunity to elevate the role of clean and efficient energy production in the aid program to Asia. This is particularly so given that the members of the Partnership include India, China, and South Korea from Asia and, with the United States and Australia, account for more than 40 per cent of the world's greenhouse gas emissions.

Political governance

4.27 Another possible option for a new area of engagement is in **political governance**. Political leadership and governance clearly have direct and strategically significant effects on the rate and quality of economic growth: each of the economic histories of China, India, Indonesia, Vietnam, Cambodia, Laos, South Korea, Singapore, Philippines, Burma, and others over the last 50 years tell a vividly contrasting story about the central role of political governance in facilitating – or destroying – growth prospects. The importance of political governance on growth continues today. In July this year Moody's downgraded its outlook for the Philippines sovereign debt from stable to negative, and Standard and Poor also downgraded 'citing concerns over the direction of badly needed economic reforms in the light of the (political) turmoil'.⁴⁴

4.28 Australian aid can assist the process of political governance without being unacceptably intrusive: the key is to have demand driven, not supply driven, responses. Some assistance can be quite direct, such as support for a country's electoral process as Australia has done in East Timor, Cambodia and elsewhere.

4.29 In the right circumstances, Australia could also lever up its impact on the reform agenda

more broadly by working in partnership with the multilateral development banks. These banks increasingly recognise the relevance and role of political governance in reform but are prevented from being involved in more direct 'political' activities by their founding charters. There may well be circumstances where a partner government in a developing country may welcome Australian aid-funded analytical research or pilot testing of a reform process that is initially in the domain of political governance that could later be supported by larger funding through a World Bank or ADB program.

4.30 In other cases the most valued, highest impact, and most durable assistance may be activities which enable the countries themselves to push reform from within. The Australian aid program has a lot to offer here. Helping build a critical mass of reformers through a modernised and expanded scholarships program is one major initiative open to the Australian Government (paragraph 4.2). Another option is to provide substantial support to centers of excellence that generate high quality – but applied – research: putting quality data in the hands of reformers (or the public) can be a potent force for reform. Shifting the emphasis in aid from the *what* of reform delivered through technical assistance to the *how* of reform through the power of ideas and applied analytical research is another option (paragraph 5.5). It is clear that demand driven assistance can enable Australian engagement in strategically significant but otherwise politically sensitive institutions.⁴⁵

Agents for change

4.31 Young people are potential agents for change in demanding reform, including in fragile states. But they are also potential agents for instability, especially if unemployed (paragraph 1.22). The challenge for an aid program is to help shape young people into forces for political reform, not forces for political instability. A development focus on education and

44 'Arroyo hangs on as middle class shops'. *The Australian Financial Review*. 14 July 2005. Page 12.

45 Australia discussed with China about aid supported research and training activities with the Communist Party School in Beijing which trains China's elite. Discussions in Vietnam also indicate there would be no political impediment to Australia supporting research for the Office of the National Assembly.

employment opportunities for **young people in fragile states** can help reduce the disaffection among young men that can be so destabilising, and thereby help promote governance and stability. This can be done by working directly and innovatively to help build a vibrant private sector, putting more emphasis on technical and vocational education, and giving more attention to employment intensive approaches to infrastructure investments and rural development.

4.32 There is also scope to promote the role of women as agents for change in situations of conflict and instability and to help drive demand for better governance, particularly in the Philippines where women have a successful record of driving change, including at the community level. Other possible agents for change might be the churches in countries like the Philippines and East Timor.

Recommendations on *how* Australia should respond

RECOMMENDATIONS ON HOW AUSTRALIA SHOULD RESPOND

5.1 Australia already has a number of comparative advantages in the way it approaches and delivers aid. Based on conversations with stakeholders in the region, these include: policy coherence and a whole-of-government approach to development issues in the region (trade policy aligns with aid and development policy etc); a long-term commitment to engagement in the region (evidenced also by the ten-year timeframe of this White Paper); and positive characteristics of aid delivery (primarily grant aid, involving competent technical expertise, managed through a single, professional, devolved, aid agency).

5.2 But if Australia is to have impact in a rapidly changing Asia over the coming decades, it needs to consider three changes in the way it delivers aid, as outlined in this section.

MULTILATERAL BANKS

5.3 First, Australia needs to be much more strategic and proactive in the way it engages with large **multilateral** development institutions in the region. Loan disbursements from the World Bank to Asia

totaled US\$5.27 billion in 2004.⁴⁶ Loan approvals from the ADB to the region in 2004 provided a further US\$5.3 billion. Lending from these two institutions alone is 30 times larger than the US\$463 million Australian bilateral program to the region. Australia, an essentially grant donor with strong country presence and knowledge of the region, should be in a good position to leverage the policy and lending operations of such organisations.

5.4 But aid is more than development finance. Increasingly, effective development is about the transfer of ideas as much as it is about the transfer of resources. Many would say this seems to be particularly true in Asia, which has an insatiable appetite for learning the pragmatic lessons of reform. It is also true for fragile states where traditional or large financing packages may not be appropriate. Well-constructed and applied analytical research done jointly with the banks – particularly early in the banks' consideration of issues – can help shape the banks' subsequent approaches in the region. The banks are clear that they would welcome a much stronger analytical and advocacy role from Australia in the region (see also following paragraph).

⁴⁶ US\$2.7 billion to South Asia, of which US\$1.835 billion was from the highly concessional International Development Association (the IDA arm of the World Bank) and the balance from the regular IBRD arm of the bank; and US\$2.55 billion to East Asia and the Pacific, of which US\$1.7 billion was IBRD and the balance IDA. While lending to the Pacific is included in this grouping, actual levels are quite small.

ANALYSIS AND IDEAS

5.5 The second change that Australia should consider in the way it delivers aid is therefore to be much more **proactive in the generation and dissemination of analysis and ideas related to development**.

Australia has a good base here. Australian aid is seen as particularly innovative and prepared to test new ideas and approaches. Several Australian universities specialise in, or have close formal links with, countries in Asia. These countries argue that, notwithstanding its developed country status, Australia's reform experience over the past decades is instructive in areas as diverse as trade policy and industry restructuring, health financing, education policy, public sector reform, public financing, and public-private partnerships for infrastructure development. That these reforms occur within a federal system, and in a mixed economy, has resonance and lessons for reform minded Asia.

5.6 There is much Australia can do to generate analysis and ideas at a practical level. Australian aid could more actively undertake the type of applied operational research that the World Bank and ADB do and which can have such a large impact on ways of promoting development in the region.⁴⁷ More emphasis could be given to capturing and disseminating the lessons of particular reform efforts, including but not limited to the trial and pilot aid activities that occur in the region, but which often do not get scaled up.

5.7 The Australian Government may wish to establish a specialised research institute on development issues, similar to the UK Overseas Development Institute. Alternatively, the ten-year time frame of this White Paper could be an opportunity for developing longer term partnering links between AusAID and research institutions in Australia and overseas that address development issues. Another option could be to use the aid program as a means of fostering longer term partnering links between Australian research institutes and their counterparts

overseas. Whatever option is chosen, increased use of research institutes could be designed to complement and reinforce the development benefits of an expanded role for scholarships in Asia.

CHANGING AID ARCHITECTURE

5.8 The third change Australia should consider in the way it delivers aid in the coming decade arises from the **rapidly changing environment for aid and overall aid architecture in Asia**.

Multilateral

5.9 At the **multilateral** level, the coming decade will see major changes to the way the World Bank and ADB engage in the region. Both institutions are evaluating their future role, especially since some large middle income borrowers can access international capital markets readily and may not need to borrow from banks. Both institutions will need to develop how they engage with fragile states, especially when traditional lending products are not appropriate. And both will need to accommodate the increasingly active role being played by India and China as *donors* rather than *borrowers* to banks.

5.10 The role and significance of other multilateral institutions on Asia's economic and development path will also change over the coming decade. Many would argue that in a dynamic and globalising region like Asia, decisions made – or *not* made - under the auspices of the WTO over the coming decade will have a greater impact on growth and development in Asia than will traditional development financing institutions. And others believe the International Monetary Fund's (IMF) role in development in Asia may decline somewhat over the decade as more countries build strong foreign exchange reserves.

5.11 Aid architecture in the region over the coming decade will also be affected by new institutions such as the Global Fund to fight AIDS, TB and

⁴⁷ Examples of high quality applied operational research include *Achieving the Twin Objectives of Efficiency and Equity: Contracting Health Services In Cambodia*. Indu Bhushan et al. ERD Policy Brief Series Number 6. Asian Development Bank. 2004. Examples from the World Bank include *Doing Business in 2005: Removing Obstacles to Growth* as well as the innovative work on output based aid (www.gpoba.org)

Malaria, the Global Alliance for Vaccine Initiative, and the Gates Foundation. The initiatives of these institutions are to be welcomed, but new challenges arise when their potentially large funding flows⁴⁸ occur outside of traditional donor coordination mechanisms or without necessarily having strong capacity building support structures to make use of such funds. There is much Australia could do to work alongside these large, well funded, and innovative foundations. Examples include helping partner governments design and appraise their proposals to such funding bodies; building capacity for the operation of approved funding; and plugging the critical gaps that often emerge in interventions and which undermine broader development effectiveness.

Regional

5.12 Important initiatives likely to continue at a **regional and subregional** level in the coming decade include the East Asia Summit, Asia Pacific Economic Cooperation (APEC) and the Mekong subregion cooperation. Several regional arrangements have emerged since the Asian crisis, aimed at preventing and enabling better responses to future crises. These include the Association of South East Asian Nations (ASEAN) +3 group (ASEAN plus China, Japan and South Korea), which is becoming the key vehicle for policy dialogue and cooperation in Asia - though the East Asia Summit might evolve into this role over coming years; the Chiang Mai Initiative established by ASEAN+3 for cooperation in crisis financing; the G-20 which includes the major East Asian economies and is a forum for driving the international economic and financial agenda; and the Asian Bond Fund to deepen regional capital markets and increase countries' capacities to borrow in their own currencies.⁴⁹ An Asian Monetary Fund to promote regional financial and economic

stability has also been mooted several times and no consensus to establish such an institution has been reached.⁵⁰

Bilateral

5.13 At the **bilateral** level, several changes can be expected over the coming decade. Amongst traditional Western donors, there will be a consolidation of donor coordination and harmonisation, as per the Paris Declaration on Aid Effectiveness. This welcome move may occur just as some of the traditional European donors think about exiting programs to countries like Vietnam. On the other hand, new non OECD donors will continue to emerge in Asia. China already is emerging as a potentially significant aid donor⁵¹ and South Korea has been an aid donor for some time. Thailand is likewise emerging as a bilateral donor and Vietnam became a donor to the World Food Program in 2005. These trends are likely to increase over the coming decade.

Non traditional

5.14 Asia will also see dramatic changes in the nature of development and broader capital financing over the coming decade. Foreign direct investment is likely to continue to be a major source of finance⁵² for the region, although concentrated in certain countries and bypassing fragile states and poorly managed countries. However **non-traditional sources of development** – for example remittances and migration – will also be increasingly important. In 36 countries worldwide already, remittances are greater than all other sources of financial capital combined.⁵³ This is particularly true for the Philippines, where almost one-quarter of the domestic labour force works overseas, worker remittances total around US\$7 billion per year, and remittances represent nine per cent of GDP and are six times larger

48 For example, the recently established Global Fund has \$US6.9 billion proposals already approved.

49 Martin Parkinson, Steve Kennedy and Gordon de Brouwer, 'Economic growth stresses and opportunities in the Asia/Pacific, Address to the Leading Australia's Future in Asia Program. ANU. 28 June 2004. Page 15. Peter Costello, 'Australia and the Asia-Pacific: Moving forwards as partners, Address to The Macroeconomic Policy and Structural Change in Asia Conference, Sydney, 24 February 2005.

50 Gordon de Brouwer, 'Institutions to promote financial stability: Reflections on East Asia and an Asian Monetary Fund', Treasury Working paper, February 2004, September 2004. Page 21.

51 *Dragon in Paradise: China's Rising Star in Oceania*. John Henderson and Benjamin Reilly. *The National Interest*. Summer 2003.

52 Asia and the Pacific region recorded more than US\$166 billion in foreign direct investment in 2004.

53 *The Future of Aid 1*. World Bank Public Policy for the Private Sector. March 2005. And by 2020 remittances from developing countries could reach US\$200 billion, dwarfing ODA, as workers fill the demographic deficit of richer, aged, OECD countries.

than foreign direct investment.⁵⁴ Remittances are also important for other countries in Asia such as Bangladesh, Indonesia, Nepal and Sri Lanka.

5.15 While large and growing, the economic impact of remittances is ambiguous.⁵⁵ Large flows may dull the demands for reform by poor communities on their national governments: some communities in the Philippines are more dependent on the quality of economic growth and economic governance in the United States, Japan, and Hong Kong than they are of their own country. Such large cross border flows of people and money also raise security questions and facilitate the spread of HIV/AIDS. Some development agencies anticipate the increased role of remittances in development generally and are working on how they can improve the development impact of such flows.⁵⁶ Australia could do more here too. A good start would be to gear up research on and the analytical base of trends and consequences of remittances in the region.

Australian aid

5.16 All of this has implications for Australian aid. The rapidly evolving 'aid architecture' in Asia suggests Australian aid must continue to be flexible and opportunistic if it is to retain its relevance and impact in the region. But flexibility needs to be balanced against the risk of an aid program being simply reactive and dissipating its efforts across the welter of challenges that will continue to emerge in Asia. Several informed stakeholders in the region have argued that if Australia is to maximise its development impact it must identify key priority issues and stick with them. Development is a long-term process, and reform takes longer than a typical three-year project horizon.⁵⁷ Above all, Australia was urged to avoid the temptation of chasing development fads.

5.17 How Australia might balance this need for strategic focus in a region as large as Asia, while maintaining flexibility in a rapidly changing environment is addressed in the next section.

54 *Migration and Foreign Remittances in the Philippines* Burgess and Haksar. IMF Working Paper WP/05/111. June 2005.

55 *Remittances As Development Finance*. Mimeograph available from OECD Development Assistance Committee website. See also *Migration and Foreign Remittances in the Philippines*.

56 See *Remittances As Development Finance*. Mimeograph available from OECD Development Assistance Committee website. See also *Sending Money Home? A Survey of Remittance Products and Services in the United Kingdom*. DFID and Banking Code Standards Board. 2005.

57 The 2004 *Review of ADB's Poverty Reduction Strategy* notes, for example, that on average 'roads have a seven-year lag from an increase in expenditure; expenditure an 11-year lag, and research and extension 13 years before actual impacts can be achieved'.

Country strategies

6.1 Previous sections have looked at the *what* and *how* issues of a modern development program to Asia. This final section looks at *where* issues. This does not mean individual country-by-country recommendations for each country in Asia – space limitations prevent that. In any event, recommendations made now about country priorities will inevitably change in a region as vast and varied as Asia: reformist governments – or state collapse – in North Korea or Burma over the coming decade would likely see a rapid scaling up of Australian assistance to those countries and a reordering of country allocation priorities. With these comments in mind, these recommendations are made.

INDONESIA

6.2 First, **Indonesia** should continue to be Australia's major development partner in Asia. The reason is obvious. Indonesia has major development needs: for example just over half of the population lives on less than US\$2 per day; less than 20 per cent of households have access to piped water; and only 40 per cent of those eligible are enrolled in senior high school.⁵⁸ That is reason enough for an active aid program. But these deep development needs are overlaid by Australia's own national interests which are closely intertwined with Indonesia being stable,

prosperous, and well governed. The path Indonesia follows over the coming decade will affect not just the fourth largest country in the world, and Australia's nearest neighbour, but the pattern of development in South-East Asia generally. It is therefore in Australia's national interest to have active, broad engagement in the development of Indonesia. The issue is sufficiently important that there is a separate, stand alone, chapter prepared on Indonesia for the White Paper.

EAST TIMOR

6.3 Despite obvious differences, similar principles apply in **East Timor**: there is a conjunction between deep development needs, proximity and broad Australian national interests. More specifically, East Timor is a Least Developed Country with a non-petroleum GDP per capita of just US\$366; a well regarded and prudent approach to managing potentially large oil revenues but severe institutional and capacity constraints; and the world's highest fertility rate of 7.8 children per woman.⁵⁹ East Timor also faces the potentially explosive challenge of youth employment, with all the implications this has for social tension and political instability near to Australia.

⁵⁸ *Indonesia: New Directions*. World Bank CGI brief. January 2005. Pages 8 and 73.

⁵⁹ Source: World Bank at www.worldbank.org/timorleste

6.4 Development need, proximity, and breadth of national interest would therefore again suggest that Australia has a broad spectrum, long term, and substantial program to East Timor. A strategic vision for this program over the coming decade would involve three pillars. The first pillar is a focus on maintaining stability in East Timor through support for its institutions of governance and the police. The second pillar would be developing human capacity in East Timor – an area of acute need and a significant constraint to economic growth and development on all other fronts. This would include support for basic, secondary and vocational education, as well as continuing to offer scholarships to Australian institutions. The third pillar involves improving viable youth employment by working more directly and innovatively to help build a vibrant private sector and giving more attention to employment intensive approaches to infrastructure investments, especially in rural environments.

PHILIPPINES

6.5 Development need, proximity, and national interest – especially security interests – would suggest that Australia give much more attention to the **Philippines – especially Southern Philippines**. Fourteen of the 20 poorest provinces in the Philippines are in Mindanao, and the incidence of poverty – already the highest in the Philippines – has increased from 56 per cent in the early 1990s to more than 70 per cent in 2000.⁶⁰ This development challenge also overlaps with important security challenges: one World Bank research paper concludes that the Mindanao conflict, having persisted for five centuries, is now the second oldest on earth after Sudan; that there have been more than 120,000 conflict related deaths in Mindanao since the 1970s; and an estimated \$US2 to \$US3 billion in direct economic costs.⁶¹ The insurgent groups Abu Sayaff and the Moro Islamic Liberation Front have links with Jemaah Islamiyah, and Abu Sayaff

has links with Al Qaeda. The promotion of stability in Southern Philippines is essential to attract investment and reduce the linkages with regional and international terrorism.

6.6 Four specific interventions would make a strategic impact in the Southern Philippines – albeit over a long-term horizon.

6.7 The first is education, which is the foundation of development, good governance, and employment – all of which CAN help reduce a sense of alienation and the appeal of terrorism. The Philippines has many challenges here: as just one example it has slipped to a ranking of 42 and 43 out of 46 countries in mathematics and science.⁶² Particular challenges arise in Southern Philippines: enrolment rates for secondary schools in the Autonomous Region of Muslim Mindanao (ARMM) were just 32 per cent, and fewer than two in ten children who enter grade one in ARMM complete high school.⁶³

6.8 Australia already has a good model for strengthening and broadening educational opportunities for Muslim children in Southern Philippines, including improving the professionalism of teachers and upgrading physical facilities of schools. The approach adopted under the AusAID-supported Basic Education Assistance to Mindanao (BEAM) is so successful that it is being scaled up and rolled out nationally. More assistance in this area would seem justified.

6.9 The second area involves a focus on women as potential peace builders. Like young people, women can be agents of change in society, demanding reform and an end to conflict. Such an approach could draw on the role of women's groups in helping to end hostilities in Bougainville and Solomon Islands, and involve support for women's groups to create a demand for long-term peace and better governance in Mindanao.

6.10 The third area involves creating viable employment opportunities, thereby giving young

60 *The Mindanao Conflict in the Philippines: Roots, Costs, and Potential Peace Dividend*. Salvatore Sciavo – Campo and Mary Judd. The World Bank. Social Development Papers: number 24. February 2005.

61 *The Mindanao Conflict in the Philippines*. Op cit. Page 5.

62 *Education Reforms in East Asia: Policy Process and Impact*. East Asia Decentralises. World Bank. Page 181.

63 *Education Reforms in East Asia*: Op cit. Pages 193 and 194.

men a stake in their own society. This, of course, is a long-term prospect and challenging, especially given lack of investment in the area and the weak and generally declining competitiveness of the Philippines (Table Two). And there are limits to what an aid program can do to create employment. The promotion of stability – a precondition for investment, economic growth and employment creation – is one area in which aid can assist.

6.11 The fourth area involves continued support for the peace process in the Southern Philippines, to lessen the instability affecting many lives and being exploited by external terrorist operatives. And continuing to build local security infrastructure, including policing, counter-terrorism and border security capacity, will help promote stability and is in Australia's direct security interest.

6.12 The challenge for Australia is how to engage in this part of the Philippines which, in many ways, represents a failed state where basic security of aid personnel is at question. This also offers real opportunities for innovative designs and approaches: more will have to be done with and through local counterparts and NGOs, and less through expatriate consultants – an approach that, in itself, could be effective.

6.13 There is also scope to help build demand for better governance in the Philippines more broadly, through supporting potential agents for change such as womens' groups.

MEKONG COUNTRIES

6.14 Further North are the **Mekong countries**. To have impact in this region over the coming decade a development strategy will need to take into account the following. First, the region is highly diverse and changing rapidly: in a decade's time there will still be a need for a development program with Cambodia, and Lao PDR, but this is unlikely to be the case with

Thailand. The engagement strategy will also need to keep pace with the rapidly changing nature of Vietnam. Second, Australia is just one of a number of developed countries active in the region, so how to work with others, and have impact ourselves, will be different to working in, say, Melanesia. The third factor is the geographical proximity of these countries to fast growing China and India, and the range of social and economic consequences likely to arise over the coming decade from the dynamic changes in those two countries.

6.15 Australia has a broad range of development and national interests at play in these countries. But if Australia is to have identifiable impact in this region it must be increasingly selective, choose a few core areas, stick with them, and then work assiduously with bilateral and multilateral agencies to leverage up our impact. The self reinforcing package of interventions outlined in paragraphs 7.4 and 7.5 would maximise Australia's impact. Australia must avoid having a range of isolated or fragmented activities that last only a few years and are then replaced by activities in new sectors.

6.16 One specific initiative where Australia could help shape areas of major strategic impact is the **Greater Mekong Subregion (GMS)**. This grouping of six countries⁶⁴ covers some 300 million people most of whom have a per capita income of US\$1 per day.⁶⁵ The ADB is an active supporter of this grouping and helps facilitate activities in agriculture, energy, the environment, human resource development, investment, telecommunications, tourism, trade, and transport. The GMS offers an entry point to a region that is large, poor, facing major internal and cross-border challenges with the potential to affect Australia (such as environmental problems and transnational crime), and where well designed aid interventions from Australia could have disproportionately large impact.

⁶⁴ Cambodia, China, Lao PDR, Myanmar, Thailand, and Vietnam.

⁶⁵ ADB website: Greater Mekong Subregion.

CHINA, INDIA AND SOUTH ASIA

6.17 Should Australia be providing aid to **China and India** in the coming decade? Many would argue that, with their size and rapid growth, aid to these two giants is no longer appropriate. After all, China's GDP is already larger than that of Italy, will overtake that of France this year, and will probably overtake that of Germany by 2007.⁶⁶ Similarly, India's economy is projected to overtake Japan's in the next five years to become the third largest in the world.⁶⁷ At a simplistic level it is hard to see how resource transfers through Official Development Assistance (ODA) can make a difference in such large economies: China's foreign exchange reserves are now reportedly growing at US\$570 million per day or US\$24 million per hour⁶⁸ – not a lot short of what Australia provides per year in aid. Indeed, China and India are active providers of bilateral and multilateral aid in their own right.

6.18 There are, however, two reasons why Australia should continue to have a development program with China and India – albeit one that is more forward looking and appropriate to the changing and contemporary realities of these countries.

6.19 The first is development need. Despite their rapid growth, China and India account for 40 per cent of the developing world's population.⁶⁹ An estimated 212 million people lived below the US\$1 a day poverty line in China in 2001⁷⁰ and China still has an estimated 594 million below the US\$2 a day line. China also has major social challenges to confront, one symptom of which is the estimated 156,841 women committing suicide every year: 56 per cent of all female suicides in the world.⁷¹

6.20 India has similar challenges. As of 2001, per capita gross national income was just US\$460, and more than one-quarter of India's population still live below the country's poverty line. As the World Bank notes: 'This means that, with the world's second largest population – over one billion – India is home to over one third of the world's poor people.'⁷²

6.21 In short, East and South Asia is still the epicenter of poverty and development need in the world.

6.22 However an even more telling reason for continuing – but modernising – Australia's program to China and India is Australia's own national interest. A continued focus by China and India on economic reform, broad based and sustainable economic growth, and social and political stability will directly affect the prosperity and stability of one-third of the world's population living within their borders. It will also be a principal determinant of the pace and pattern of economic growth and stability in the region. It is therefore in Australia's national interest to use every instrument available to it – including the aid program – to help sustain the momentum of positive reform by those two giants. It makes no sense for Australia to disengage from the two largest drivers of growth and security in the region over the coming decade.

6.23 Five things need to occur if Australia is to make an impact on the directions China and India might take in the coming decade. First, any development program must be highly selective and essentially built around one, or at most two, central themes or flagships known to be of top priority to the leadership group of those two countries. Second, the flagship must be large enough in size; innovative enough in scope; and long enough in duration, to gain the

66 Goldman Sachs Global Economic Paper. Op cit. China is also projected to be the third largest economy after the United States and Japan by 2015 and, even with growth rates slowing to 3.5 per cent by the mid 2040s, the world's largest economy by 2041. While China and India's emergence as global – not just regional – economic powers is impressive, it does not mean they will come to the table as 'wealthy' as the countries they displaced. Even by 2050 China's GDP per capita is projected to be just US\$31,357 (2003 constant dollars) and India's just US\$17,366 compared to that of the United States of US\$83,710 and Japan's of US\$66,805.

67 *A Tripolar World: India China and the US*. Arvind Virmani. Indian Council for Research on International Economic Relations. May 18 2005.

68 *Money's On August Revaluation in the Australian Financial Review*. 19 July 2005. Page 11.

69 *Economic Growth in the 1990s*. Op cit. Page 7.

70 *World Development Indicators 2004*. Page 3.

71 *China 2001–2010: Political Economic and Social Issues of Reform and Transformation*. FitzGerald, Davies and Tang. Page 50.

72 India is still home to the world's largest number of illiterate people and accounts for 20 per cent of the world's out of school children and for 20 per cent of the gender gap in elementary education. Maternal deaths in India account for almost 25 per cent of the world's childbirth related deaths.⁷² Similar challenges arise in the rest of South Asia.

attention of the leadership groups in these countries, particularly so with India.⁷³ (Having said that, it is also clear that the aid budget is finite and priorities have to be set. The convergence of development needs, geographical proximity, and the breadth and depth of national interests at stake suggest that Indonesia, East Timor and the Philippines will usually get first priority from Australia.) Third, a flagship must be as much about ideas as about finances. Fourth, all components of development cooperation, including scholarships, analytical research and think tanks, Australian engagement with the World Bank and the ADB, must be managed so they work in harmony and reinforce each other. Fifth, a traditional donor-recipient model needs to rapidly change to a more partnering approach to reflect the capacity and sophistication of China and India.

6.24 Numerous options are available to the Australian Government. The boldest – yet possibly the most cost effective and high-impact – is sketched out here.

A bold proposal: a single flagship for China and South Asia for the coming decade

Australia chooses one strategically important issue that is a core priority for development across East and South Asia and which aligns with its comparative advantage and national interests. This might be the technical, scientific and policy aspects of clean energy and greenhouse gas emissions. It might be an aspect of economic policy and governance, such as public-private partnerships for infrastructure funding. It might be girls' education and/or professionalising basic education across the region through to Pakistan. It might be work on pandemics, including HIV/AIDS or TB.

Over time, Australia consolidates its funding efforts around this flagship. By way of illustration, if all of Australia's current aid program to China and South Asia were consolidated, there would be

a flagship intervention worth around AUS\$94.4 million, or AUS\$940 million in current dollars over ten years. This, by itself, would have more impact than a series of fragmented bilateral programs.

The impact would be enhanced by the overlapping and reinforcing components that would come with a scaled up and single focus initiative: a large scholarships program would build a critical mass of leaders in the region trained in Australia and networking with each other. The returning scholars would link up with research institutes, think tanks, and broader whole-of-government initiatives that AusAID was supporting under the flagship. The ideas and reforms being generated by this interaction would also feed into, and itself be influenced by, the analytical, policy and operational programs of the World Bank and ADB in that area.

Such a model gives strategic focus, but also enables flexibility to respond to changing circumstances. For example the degree of focus, and the intellectual leadership role taken by Australia under this flagship model, would enable a range of ongoing, well grounded, new initiatives to be developed for consideration by the Australian Government, each of which could meet the changing needs of the time or the country concerned. If necessary, a separate but relatively small rapid response facility could be available to allow Government to pursue initiatives outside of the single flagship – but without detracting from or diluting it.

6.25 Numerous and less radical permutations are also possible. Government might choose to have, for example, two larger, longer term flagship programs to India and China: one on the high tech side dealing with clean and efficient energy/global warming and the other on the humanitarian side dealing with girls' education. Alternatively, one flagship could be economic governance and reform,

⁷³ The level of Australian aid and broader engagement with India has gone through cyclical peaks and troughs over the decades. Separately, India has recently decided to limit its aid relations to countries with larger programs, to reduce transaction costs and fragmented efforts. Any decision to re-engage with India would need to take this into consideration.

and the other HIV/AIDS. The key is to have a focus, and then stick with it. A ten-year focus on two important streams would have impact, and balance and introduce further substance and ballast into the bilateral relationship with these two countries. Such a program could also be supplemented by a regional program for the other countries of Asia (Sri Lanka, Bangladesh, Pakistan, Nepal, Bhutan, and Maldives).

RESOURCE IMPLICATIONS

7.1 Moving Australia's aid program upstream in the way outlined in this paper has resource implications for AusAID, other Australian Government departments, and Australian research institutions and universities. Aid is a finite resource and its development effectiveness needs to be regularly assessed and the lessons learnt better identified, disseminated and digested by development agencies, partner governments, and other stakeholders. If development shifts to a more upstream and analytical approach over the coming decade, there will also be resource implications for AusAID staff. This might include the need to develop even stronger analytical and technical skills – or ready access to those skills – to be able to engage productively with national counterparts, research institutions, the World Bank, and ADB.

Conclusion

8.1 The strategic starting point for this paper is that Asia is large, varied and changing rapidly. Growth will be an essential pre-condition – but not a guarantee – of poverty reduction, as well as stability in the region and beyond. Australia's national interests are inextricably bound up in the path of economic and social development of Asia over the coming decade. Australia's aid program, as part of a whole-of-government engagement in the region, can help shape the response to the challenges of the coming decade.

8.2 Achieving impact in such a large and varied region as Asia is a challenge. Several recommendations are made.

8.3 First, in terms of sectors, Australia should further consolidate its efforts in economic governance, emphasising links to service delivery and the environment for the private sector. Opportunities exist for significant scaling up of existing work in health, education and rural development. And if Australia is to help shape some of the main drivers of change in Asia in the coming decade, it should also consider new fields like physical infrastructure and political governance.

8.4 Second, the ten-year timeframe of the White Paper is an opportunity for Australia to be much more strategic and forward looking in the way it delivers aid in the region. Australia should invest more attention and resources into its relations with the multilateral development banks to help shape the way these much larger institutions engage in Asia.

Linked to this, Australia should give even greater priority over the coming decade to generating ideas and applied research about development, which can empower reformers in Asia to themselves push forward. This should be complemented with an expanded scholarships program, as well as stronger institution-to-institution links, to help build a critical mass of reform from within. And Australia should look carefully at the rapidly evolving aid architecture in Asia and work more closely with institutions that will shape the economic, social and development agenda in Asia over the coming decade.

8.5 These components – expanded scholarships, improved institution-to-institution links, generating ideas and research, working more closely with multilateral development banks and new institutions – complement and reinforce each other. They work best as a self reinforcing package. And, with adaptation to individual country circumstances, the package works well in fast growing large economies, smaller fragile states, and the range of countries in between.

8.6 Third, Australia should be focused and strategic in its choices about operating at a country level. Indonesia, East Timor, and, to an extent, the Southern Philippines share the characteristics of particularly strong development needs, proximity and a dense web of Australian national interests. That would suggest tailored country programs that might be reasonably large (Indonesia), broad based (East Timor) or innovative (southern Philippines). As the

spotlight moves further North and West – through the Mekong countries and into the larger domains of China and South Asia – the need for strategic focus becomes even more pressing. There are ways of getting focus and impact in these regions, but this involves being increasingly selective and sticking with an area for longer periods. It also involves working creatively with large stakeholders such as the multilateral banks.

8.7 The package of approaches in this paper will give focus, coherence and strategic direction to Australia's aid program to Asia over the coming decade. But it will also enable the program to be sufficiently flexible and responsive to the varied, and rapidly changing, countries of Asia.

Glossary

ADB	Asian Development Bank
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BEAM	Basic Education Assistance to Mindanao
GMS	Greater Mekong Subregion
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LICUS	Low Income Country Under Stress
MILF	Moro Islamic Liberation Front
ODA	Official Development Assistance
WTO	World Trade Organization



7

Indonesia

Analytical report for the White Paper on Australia's aid program

Prepared by
Mark Baird and Peter Versegi

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Executive summary

i. Despite setbacks from the recent Tsunami and regular terrorist threats, there is growing confidence in Indonesia that a democratic and decentralised system can work. This confidence has been bolstered by the successful elections last year and signs of a pick up in investment and economic growth. Economic management remains sound and the new Government has shown encouraging signs of a readiness to tackle corruption. There is also evidence of more effective local administration in a number of provinces and districts.

ii. Even so, economic growth remains well below the levels needed to provide enough jobs, especially for the poor and young, and to keep pace with the Asian giants of China and India. The investment climate is still very weak compared to other countries in the region and there are troubling signs of a breakdown in basic health services, with recent reports of polio, malnutrition and avian influenza in some areas. If not well handled, these developments could undermine support for the Government and the democratic process.

iii. Australia has a strong national interest in a stable, prosperous, unified, and democratic Indonesia. The aid program has evolved in a responsive and flexible way over the past five years to meet this objective, in a rapidly changing political and economic environment. AusAID played a useful role in helping Indonesia overcome short-term threats from the 1997 financial crisis and the recent Tsunami. It is also supporting longer-term programs to improve

governance and deliver better education and health services. With the addition of the Australia Indonesia Partnership for Reconstruction and Development (AIPRD), Australia's aid program in Indonesia is estimated to rise to A\$300 million in 2005–06, signaling a growing commitment to development.

iv. This is therefore a good time to work through what Australia wants to achieve with its expanded aid program in Indonesia over the medium term. This report identifies five sets of strategic issues related to: (a) positioning Australia's aid program; (b) building institutional and human capacity; (c) scaling up the growth agenda; (d) integrating program management; and (e) strengthening partnerships. It broadly endorses the emerging focus of the existing development cooperation program on longer-term institution building, especially in Eastern Indonesia, and the proposed focus of the new AIPRD on broad-based economic growth. The main questions relate to how these programs will be delivered.

POSITIONING AUSTRALIA'S AID PROGRAM

v. Indonesia is now the third largest recipient of Australian aid after Papua New Guinea (PNG) and the Solomon Islands. Australia has also become the second largest bilateral donor to Indonesia after Japan. However, whereas Australia accounts for the dominant share of aid flows to PNG and the Solomon Islands, it is only about 10 per cent in Indonesia. Compared to the overall population

and national income of Indonesia, the amount of Australian aid is modest, similar to its role in other Asian countries.

vi. Taken with the deeper and broader Australian Government engagement, being a major donor in a large country is a new position for Australia and the aid program will have to be carefully positioned to reflect this. The Government of Indonesia (GOI) will want a major say on how AIPRD funds are spent. Other donors will want to partner with Australia, pooling resources and leveraging Australia's leadership role in some areas. At the same time, Australian politicians and officials will expect a high profile and want to see solid returns for their A\$1 billion investment in AIPRD. Marrying these viewpoints will be a major challenge facing the Indonesian aid program over the medium term.

vii. Another challenge will be maintaining momentum on the program in the face of unexpected developments and setbacks. Natural disasters and terrorist threats will be recurring realities in Indonesia, and flexibility to respond quickly has to be built into the program's strategy. Public opinion in Australia also wavers on Indonesia, as evidenced during the recent court case of Schapelle Corby. The Australian Government will have to carefully and constantly explain its national interest to the public and protect the aid program from unjustified swings in support.

viii. A related issue is the timeframe of Australia's expanded engagement in Indonesia. AIPRD is a five-year program, which largely mirrors the term of President Yudhoyono's government. While it is perhaps too early to decide whether the AIPRD commitment will continue beyond 2009, the decision should not be postponed for too long – expectations will start to develop about the role Australia will play and it would be unwise to signal a cutback in support during an election year in Indonesia.

BUILDING INSTITUTIONAL AND HUMAN CAPACITY

ix. Ad hoc responses to the financial crisis and Tsunami have inevitably delayed implementation of AusAID's longer-term programs to build institutional and human capacity. However, these

programs are expected to play a more central role in the years ahead. Recent initiatives in governance, human resource development, and regional development and decentralisation are good examples of how Australia can support capacity building.

x. **Governance.** Australian technical assistance helped GOI to respond to the Asian financial crisis and to strengthen economic governance more broadly, such as in debt management, bank supervision, tax administration, and anti-money laundering. Most support for economic management has been provided through the Technical Assistance Management Facility (TAMF). The Government Partnerships Fund under AIPRD provides opportunity to scale up these efforts and to improve coordination of separate technical assistance activities by different government departments. GOI officials welcome this type of support, provided the technical advisers are able to respond flexibly to Indonesian priorities and work effectively within the Indonesian system.

xi. Another key component of Australia's governance program is the Legal Development Facility (LDF). The LDF aims to strengthen the capacity of Indonesian government institutions and civil society to promote legal reform and protect human rights. This support is highly regarded, and Australia may be asked to play more of a leadership role on legal reform. However, it will take patience and persistence to convert these efforts into sustainable results. A long-term view of what can be achieved, and how to build support for legal reform, is therefore required.

xii. A sound legal and judicial system is essential to underpin political governance. Australia has also supported the democratic process directly through assistance for the national elections in 1999 and 2004. A new one-year program of cooperation with the newly-formed Regional Representation Council (DPD) began in December 2004. Looking forward, Australia will support the democratic process at the local level through the People's Network for Voter Education. More broadly, Australia should consider supporting civil society groups involved in monitoring the performance of local governments and politicians, and the delivery of public services.

xiii. Australia has committed A\$20 million to build Indonesia's capacity to fight transnational crime and terrorism over the next five years. Australia's approach to counter-terrorism recognises that poverty, conflict and weak governance create environments for the growth of terrorist networks. Terrorism also impacts on poverty by destroying lives and property, threatening personal security and undermining prospects for economic growth (as seen in the case of the Bali bombing). These same arguments can be extended to other transnational crimes, including drug and people smuggling. Therefore, to the extent that Australia's assistance to Indonesia can help reduce transnational crime, it is mutually beneficial to both countries.

xiv. **Human resource development.** Australia has played a leading role in the health sector, especially in supporting programs for maternal and child health care, HIV/AIDS and other communicable diseases. Other donors, including UNICEF, the United States and the United Kingdom, are interested in working with AusAID to expand these programs. The new HIV/AIDS Partnership Program should support the roll out of provincial HIV/AIDS strategies, and encourage leadership by civil society and the government of a coordinated, multi-sectoral approach. Over time, AusAID wants to extend its work on communicable diseases to more closely examine the causes of these outbreaks and find ways to prevent them.

xv. Education accounts for almost half of AusAID's assistance to Indonesia. Ongoing programs provide a solid foundation for Australia's future activities, including:

- > Programs to improve the management and delivery of basic education services. AusAID should be active in the multi-donor effort with the Ministry of National Education to develop a strategic plan for basic education, while maintaining bilateral programs shown to be delivering results.
- > The Learning Assistance Program for Islamic Schools (LAPIS) is the first significant program being implemented in this area. A great deal of effort has gone into setting up a demand-driven process for selecting priorities, and this approach is likely to be followed by other donors involved

in Islamic education (for example, the Asian Development Bank – ADB).

- > Under the expanded Australian Development Scholarships (ADS) program, more attention should be provided to developing future leaders and reformers from both the public and private sectors in all areas of Indonesia. A strong ADS alumnus would help build mutual understanding between the two countries.
- > The Specialised Training Program (STP), established in 1994, is now the key mechanism for delivering training to government, private sector and community institutions. Under AIPRD, Australia will analyse skills development and training needs in Indonesia, providing a platform for an expanded assistance program over the next five years.

xvi. **Regional development and decentralisation.**

Australia has developed considerable experience in the development challenges facing Eastern Indonesia. However, past efforts to address these through ad hoc sectoral projects have not succeeded. AusAID is shifting towards an integrated approach under the Australia Nusa Tenggara Assistance for Regional Autonomy (ANTARA) program. The program's goal is to reduce poverty in East Nusa Tenggara (NTT) and West Nusa Tenggara (NTB) by improving local governance, peri-urban and rural income, and the quality and access to basic services. The ANTARA approach may suit AusAID's activities in other regions.

xvii. Australia has a clear interest in ensuring that Papua develops into a stable and prosperous region of Indonesia. AusAID has ongoing programs there, on HIV/AIDS, maternal and child health, and basic education. AusAID has also been following closely the recent public expenditure review carried out by the World Bank and the provincial government in association with local universities and civil society groups. This review will be followed up with support for budget planning, allocation and review processes at the provincial and district levels. This may lead to further opportunities for AusAID to support policy dialogue and capacity building in the region. Given the sensitivities involved, a multi-stakeholder approach makes sense.

xviii. More generally, Australia should continue to support decentralisation. While the framework is still not perfect, it is time to shift the focus to: (a) redefining the role of central government, including setting and monitoring standards for service delivery; and (b) finding ways to fund and implement effective programs at the local level. In this context, Australia may want to participate in the new Decentralisation Support Facility (DSF) set up by the World Bank and other donors.

SCALING UP THE GROWTH AGENDA

xix. AIPRD provides a great opportunity for Australia to step up its support for economic growth in Indonesia. Higher, sustained growth is essential to create jobs and reduce poverty. The current aid program is active on two important pillars of the growth agenda – short-term macro stability and long-term institution building. But more can be achieved to fill in the middle ground and to give a much-needed boost to economic growth over the next five years. Three areas stand out for AIPRD support: (a) trade and investment policy; (b) infrastructure development; and (c) agriculture and rural development.

xx. **Trade and investment policy.** The uncertain regulatory environment in Indonesia is a main concern of investors. The Minister of Trade is keen to put in place regulatory review mechanisms that reflect the wider interests of investors and consumers. The Australian Productivity Commission (APC) may well provide relevant experience in this area and could provide a model for a similar institution in Indonesia. The Minister is also keen to strengthen the Ministry's capacity to review domestic trade restrictions and participate in external trade negotiations. AusAID responded quickly by extending the mandate of TAMF to include trade policy, and by appointing an AusAID-funded adviser to the Minister.

xxi. **Infrastructure development.** There is growing recognition of how infrastructure development can reduce poverty by supporting economic growth and service delivery. President Yudhoyono's new government has made this a top priority, but there is much to do to improve the policy and regulatory

environment. Again, AusAID responded quickly by expanding the TAMF mandate to include infrastructure development, and by appointing an infrastructure adviser to the Coordinating Committee on Policies for Accelerating Infrastructure Development (KKPPI). Australian experience with public-private partnerships in infrastructure development is likely to be relevant to Indonesia's policy choices.

xxii. The A\$500 million loan component of AIPRD will be used predominantly to finance economic and social infrastructure projects. Given the expected difficulties of setting up and managing free-standing projects, Australia is looking at collaborating with existing or planned infrastructure programs. Even so, it would be unrealistic to expect that these funds will disburse quickly. Concerns over environmental and social impacts, as well as the risks of corruption, will have to be addressed. Care will also be needed to ensure that large infrastructure projects do not distort or circumvent demand-driven processes built into existing programs (for example, LAPIS).

xxiii. **Agriculture and rural development.** AusAID's Country Strategy for Indonesia identifies agriculture and rural development as one of the five priorities for poverty reduction. The GOI recently announced its own strategy to revitalise the agriculture, fishery and forestry sectors. AIPRD has tentatively allocated A\$50 million for both private sector development and rural productivity. Australia has a great deal of experience to offer on agricultural issues and could make a major contribution. One challenge will be to look beyond agriculture at the needs for rural infrastructure and off-farm employment, as well as related issues of natural resource management.

INTEGRATING PROGRAM MANAGEMENT

xxiv. AusAID's decision to shift strategic management of the Indonesia program to Jakarta is sound. It has enhanced AusAID's stature with the GOI and the local donor community, and facilitated rapid response when needed, as at the time of Tsunami. The priority now is to integrate program management – between staff in Jakarta and Canberra, between clusters of activities within

the existing Australia-Indonesia Development Cooperation Program (AIDCP), and with the AIPRD.

xxv. A new management structure for AusAID programs in Indonesia is being considered. This could involve appointing cluster leaders to provide strategic direction and coordination to program development, and stronger oversight and guidance to project contractors. Consolidation of program management along these lines is warranted. But much will depend on the calibre of people attracted to these positions. Care will also be needed to avoid overlapping responsibilities between layers of program and project management, in Jakarta and Canberra.

xxvi. Similar efforts are underway to coordinate management between the ongoing AIDCP program and the new AIPRD. A working arrangement is in place to align similar programs (for example, for technical assistance and scholarships). This is highly desirable, and moves to integrate the programs under one common set of objectives, a single management structure and performance measurement framework are supported.

xxvii. For the longer term, the experience with tied loans should be reviewed. Initial indications suggest these will complicate the task of disbursing funds, in part because Indonesia's demand for loans is changing.

STRENGTHENING PARTNERSHIPS

xxviii. Australia is already developing closer partnerships with other donors working in the areas of Eastern Indonesia, maternal and child health and HIV/AIDS. However, the expanded scale of Australia's aid program means donor partnerships have to be explored more proactively. Collaboration with other donor programs will be important in achieving speedy and effective implementation of large, new programs such as AIPRD. By building on the analytical and implementation frameworks already established by other donors – such as the World Bank for infrastructure development – new activities can be prepared relatively quickly, with minimal additional burden on Indonesian government structures. Similar arguments in favour of harmonisation apply to supporting national

programs for public sector reform, where leadership is likely to come from multilateral agencies.

xxix. There may also be times when Australia wants to participate in sector-wide approaches to improve the coordination of aid (for example on education, health and decentralisation issues). There will be opportunities for Australian leadership in all of these areas, because of the growing size of the country's aid program and AusAID's track record of successful and innovative projects. The same applies to legal reform and possibly security and development. This leadership role will raise Australia's profile within the donor community and with the GOI. With a higher profile, Australia can ensure its support is acknowledged and branded, without undermining aid effectiveness. However, stronger leadership by the GOI will be needed to realise the full potential for improved donor coordination.

xxx. Australia should reach out to a broader range of partners in Indonesian development – in line with the people-to-people linkages envisioned under AIPRD. Good examples already exist, such as the partnership with the Asia Foundation on voter education for national and local elections. Other opportunities to partner with foundations, civil society groups and academics from Indonesia and Australia exist throughout the aid program. More generally, closer ties should be encouraged between political, religious and business leaders from the two countries. These people-to-people activities help build mutual understanding and provide valuable opportunities for learning and capacity building in Indonesia.

xxxi. In many respects, the Indonesian aid program is now unique. It is different from what Australia has undertaken in Indonesia in the past, and is now doing in other countries in Asia-Pacific. Indeed, the Indonesian aid program may point the way in some key respects, which will be relevant for the medium-term direction of Australian aid. In particular, the importance of building institutional and human capacity, the renewed focus on broad-based economic growth, ongoing efforts to integrate program management, and more proactive use of partnerships are four themes that may well have broader applicability for this White Paper.

1 Introduction

1. In his speech to Parliament on 10 March 2005, tabling the Thirteenth Annual Parliamentary Statement on *Australian Aid: An Integrated Approach*, the Minister of Foreign Affairs announced he would present a White Paper on Australia's Aid Program in a year's time. The purpose of the White Paper is to outline a medium-term strategic blueprint for the Australian aid program in the Asia-Pacific region.¹ As inputs to the White Paper process, several country and thematic reports are being prepared. This is the country report on Indonesia.

2. This report has been prepared by Mark Baird and Peter Versegi, following the terms of reference shown in Annex V.² The purpose is not to provide a detailed review or critique of AusAID's existing strategy in Indonesia. Rather it is to identify broad program priorities and delivery issues that could affect the strategic direction of the aid program over the medium term. The report is based on a review of recent literature (references attached) and discussions in Canberra and Jakarta with a wide

range of people involved in Indonesian development and the Australian aid program. Valuable comments on a draft of this report were received from a reference group of Indonesian and Australian experts.³ The views expressed are those of the authors, and do not necessarily reflect the views of the Australian Government.

1 More details on the objectives and coverage of the White Paper are provided in the Guide for the Core Team (AusAID, 2005b).

2 Mark Baird was formerly Vice President and Country Director in Indonesia for the World Bank. Peter Versegi is Assistant Director General and Head of the White Paper Secretariat in AusAID. Research assistance was provided by Sonya Gray and Rachel Payne (AusAID, Canberra). Yoichiro Ishihara (World Bank, Jakarta) helped to check and update the economic data.

3 The reference group included Dr. Boediono (former Minister of Finance, Chairman of BAPPENAS, and Deputy Governor of Bank Indonesia), Bambang Brojonegoro (Dean, Faculty of Economics, University of Indonesia), Kamala Chandrakirana (Chair, National Commission on Violence Against Women), Greg Fealy (Research Fellow in Indonesian History, Australian National University), Tim Lindsey (Director, Asian Law Center), Alan Taylor (Chairman, Australia-Indonesia Institute), John Evers (Chief Adviser, Australian Treasury), and Stephen Grenville (former Deputy Governor, Reserve Bank of Australia).

2 Indonesian development overview and outlook

RECENT POLITICAL AND ECONOMIC DEVELOPMENTS

3. After three decades of strong growth and rapid poverty reduction, the Indonesian 'miracle' started to unravel in the mid-1990s. The immediate cause of Indonesia's economic woes was the Asian financial crisis of 1997. Fundamentally, the crisis revealed basic weaknesses in the country's political and economic institutions: political power was highly centralised in President Soeharto and the ruling Golkar Party; corruption was widespread in public administration and the judicial system; and the banking system was largely insolvent, because of low capitalisation and high levels of non-performing loans (many the result of directed lending by the Government).⁴

4. Following the fall of President Soeharto in May 1998, Indonesia went through dramatic and often chaotic political changes. The country's second free and open parliamentary elections were held in June 1999 (the first were held 44 years earlier, in 1955). Soon after, the referendum and subsequent turmoil in East Timor led to United Nations' (UN) intervention and eventual independence in May 2002. The decentralisation laws of 1999 devolved most functions of government to Indonesia's

districts and cities, and provided for a significant increase in the regional share of general government spending from January 2001.⁵ Constitutional amendments passed in August 2002 provided for direct elections of the president and vice president and a fully elected legislature. The first elections under this modified system were held during 2004, leading to a new president with a substantial popular mandate, and new parliaments at the national, provincial and district levels.

5. Successive governments under Presidents Habibie, Abdurrahman Wahid, Megawati Sukarnoputri, and now Susilo Bambang Yudhoyono have performed well to restore economic stability (Table 1).⁶ Budget discipline has seen public debt reduced from more than 100 per cent of GDP in 1999 to 56 per cent in 2004. Inflation, which had soared above 80 per cent during the crisis, has averaged six to seven per cent in recent years. The exchange rate and interest rates have also returned to reasonable levels. More recently, economic growth has started to recover, reaching 5.1 per cent in 2004, the highest rate since 1996. Investment also recovered in 2004, exceeding 20 per cent of GDP for the first time since the crisis (although still well below pre-crisis levels of closer to 30 per cent).

4 For more on the Soeharto era and the lead up to the crisis, see Schwarz (1999).

5 The decentralisation laws were revised in 2004 to shift some government authority back towards the centre and to address inequities in revenue-sharing arrangements. While gaps and weaknesses in the framework for decentralisation remain, the focus is shifting to redefining the role of the central government, and finding ways to fund and implement programs at the local level, within the existing framework.

6 Economic stability was underwritten by the International Monetary Fund (IMF) program through 2003, but the GOI has established its own policy credibility over the past 18 months, including the politically difficult decision to raise fuel prices in April 2005. Even so, higher oil prices still pose significant risks to budget management and economic stability more generally.

Table 1: Recent economic trends

Indicator	Units	2001	2002	2003	Estimate 2004
GDP growth	%	3.8	4.3	4.5	5.1
Investment rate	% of GDP	19.2	19.0	18.9	21.0
Inflation (CPI)	%	11.5	11.9	6.7	6.4
Public debt	% of GDP	80.9	72.2	63.6	56.3
Interest rates (SBI)	%	16.6	14.9	9.9	7.4
Exchange rate	Rp/US\$	10 261	9 311	8 577	8 936

Source: World Bank (2005a and 2005c).

6. Poverty levels rose during the crisis, but have fallen back to pre-crisis levels (Annex I). Even so, about half the population is still living on less than US\$2 per day, with substantially higher poverty rates in rural and isolated areas of the country. Non-income aspects of poverty remain serious, as Indonesia underperforms its neighbors in access to quality health, education and other basic services. Emerging health problems are highlighted by recent reports of polio in West Java, malnutrition in West Nusa Tenggara and avian influenza in Jakarta as well as the growing prevalence of HIV/AIDS, especially in Papua and among drug users. Employment growth has also been discouraging. Indeed, the latest annual figures show that job losses in the formal sector were severe in 2002–03, with more than a million jobs lost in manufacturing. As a result, the open unemployment rate reached 9.5 per cent in 2003.⁷

7. The Tsunami on December 26, 2004 claimed at least 200 000 lives in the Indonesian province of Aceh and left more than 600 000 homeless. Economically, the impact of the disaster (at replacement cost) is estimated at US\$4.5 billion, equivalent to 97 per cent of Aceh's GDP or 2.2 per cent of national GDP. Absent the recovery effort, the direct impact of the Tsunami would have lowered national GDP by 0.1 to 0.4 per cent in 2005. However, this will be largely offset by the unprecedented donor response. The Government

released the draft Aceh Reconstruction Masterplan in March 2005, and has since set up the Rehabilitation and Reconstruction Agency (BRR) to approve and facilitate execution of reconstruction projects. A multi-donor trust fund, co-chaired by BRR and the World Bank, has also been established to help channel and oversee external support.⁸

DEVELOPMENT PRIORITIES AND PROSPECTS

8. AusAID's current Country Strategy for Indonesia, prepared in 2002, outlined plausible scenarios for growth and poverty reduction for the decade ahead. It concluded that: 'The most likely scenario is a prolonged period of economic growth of around four per cent a year, with uneven and somewhat erratic progress towards democracy (AusAID 2003a, page 13). Against this benchmark, Indonesia has probably performed somewhat better than expected, on both economic and political fronts. However, the five broad development priorities identified in the Country Strategy – building national institutions for accountable government, delivering better public services for the poor, improving access to economic opportunities for the poor and vulnerable, renewing attention to agriculture and rural development, and mitigating conflict and reducing vulnerability to natural disasters – remain valid today (Box 1).

⁷ Klasen (2005) argues that the main 'gender gap' in Indonesia is in the labour market, which still awards much lower pay for women and often forces them to work in very poor conditions.

⁸ Some donors, including Australia, have chosen to channel their reconstruction funds through bilateral projects.

BOX 1: USAID'S VIEW OF DEVELOPMENT PRIORITIES IN 2002

AusAID's Country Strategy for Indonesia identified five broad development priorities (paraphrasing from AusAID 2003a 22–23):

- > **Building national institutions for accountable government**, including legal and judicial reforms, civil service reforms, improved financial management, and adoption of measures that improve the management of the nation's rapidly depleting natural resource base. Also important are measures to strengthen democratic institutions and practices that increase opportunities for the poor to participate in policy-making and implementation. Local government will need to foster mechanisms that give the poor a greater voice in decisions that affect them.
- > **Delivering better public services for the poor.** Improved access to health, education and other basic services by the poor is not simply a matter of increased budgetary outlays. The far-reaching decentralisation of government functions means programs in education, health care, agriculture and rural development, and environmental management—that are at the heart of poverty reduction strategies—are now the responsibility of local governments. Actions will be required to strengthen capacities at the national and local levels to ensure effective delivery of public services to the poor.
- > **Improving access to economic opportunities for the poor and vulnerable**, including through access to secure possession of land and natural resources. Improvements in the legal system related to titling and pledging of collateral and other institutional measures needed to support increased lending to the poor, many of whom would be users of micro-finance programs. While these programs appeared to function well throughout the economic crisis, there is scope to consolidate the multitude of small, micro-credit programs and link them more effectively to the formal banking system.
- > **Renewing attention to agriculture and rural development**, given the predominantly rural nature of poverty in Indonesia. The main elements of a renewed strategy for agriculture and rural development should centre on such basics as agricultural research, rural extension services, reduced post-harvest crop losses, improved rural infrastructure, improved productivity in the smallholder tree crop industry, and expanded access to rural credit, including micro-credit programs. The specifics will depend on conditions in each province, including opportunities for agricultural diversification and off-farm activities.
- > **Mitigating conflict and reducing vulnerability to natural disasters.** Conflict is now seen as a chronic malaise affecting much of the country. Despite some recent positive achievements in Aceh and Maluku, the prospect for a durable solution remains uncertain and there is a possibility of nascent conflict erupting in other areas that have to date enjoyed relative calm. Indonesia is also highly prone to natural disasters, having regularly been affected by earthquakes, forest fires, floods and droughts. The combination of conflict and natural disasters has displaced millions and driven large numbers of people into poverty.

9. Progress on this reform agenda has generally been slow and uneven over the past five years. However, the new government of President Yudhoyono came to office in October 2004 with a strong mandate for change, and it moved quickly to prepare a medium-term development strategy to respond to the promises made during the election. The new development strategy, signed by the President in March 2005, identifies three broad objectives:⁹

- I **Creating a safe and peaceful Indonesia:** by resolving separatism and regional conflicts, combating conventional and transnational crimes, fighting terrorism, and strengthening national security.
- II **Establishing democracy and justice for all:** by rebuilding modern institutions and good governance, including through legal reform, improving delivery of public services, and resolving weaknesses with decentralisation.
- III **Improving prosperity:** by maintaining economic stability, sustaining higher broad-based economic growth and job creation, and enhancing access to basic services, especially for the poor.¹⁰

10. The primary economic objective of the GOI's development strategy is to raise GDP growth from five per cent in 2004 to 7.6 per cent in 2009, with an average growth rate of 6.6 per cent per annum over the next five years. The World Bank foresees growth picking up to 5.5 per cent in 2005 and six per cent in 2006 based on 'the current economic and investment momentum and a relatively supportive external economic environment. Indonesia's capacity use is historically high, and fiscal policy is evolving from macroeconomic stability through fiscal consolidation to support for higher quality growth. However, sustaining growth beyond the current cyclical upturn will require continued reforms to the investment climate.'¹¹

11. The investment climate in Indonesia remains among the worst in the region, ranking well below China and India, and even worse than the Philippines on most measures (Annex II). For example, according to the World Bank's latest Doing Business survey, it takes 151 days to start a business in Indonesia, ranking in the bottom ten worldwide. And Indonesia is ranked 133 out of 146 countries in Transparency International's index of corruption perceptions. Recent progress on political and economic stability has removed some risks facing investors and improved market sentiment.¹² Even so, firms surveyed by the World Bank indicate that costs associated with corruption and poor contract enforcement, excessive and uncertain regulations, and unreliable infrastructure can make up 20 per cent of the value of sales (compared with 8 per cent in Poland and 13 per cent in China).¹³ Corruption and poor infrastructure also impact directly on the poor, by reducing their already meagre incomes and weakening their access to basic services.

12. The new Government has given priority to tackling these constraints. Recent actions to pursue corrupt officials, reform military businesses, follow up on audit reports, and oversee reconstruction efforts in Aceh show a determination to fight corruption that has not been evident in recent years. Similarly, the Infrastructure Summit in January 2005 showed the government's willingness to address long-standing constraints to greater private sector participation in infrastructure provision. However, many constraints facing Indonesian development are institutional problems requiring long-term solutions. There will be strong pockets of resistance to reform in the civil service and political elite, and doubts remain about the government's capacity to implement its reform agenda. The main challenge will be to sustain progress and build credibility over time, while managing expectations about the pace

9 BAPPENAS (2005) and Indrawati (2005a).

10 The government released a draft Poverty Reduction Strategy (PRS) in October 2004. While the PRS was prepared largely in response to donor pressure it is seen to be a part of the new medium-term development plan, and provides more details on poverty reduction targets and programs. The United Nations Development Programme (UNDP) is helping local governments prepare their own poverty reduction strategies.

11 All quotes from the World Bank (2005c), page 2.

12 Improved market sentiment is reflected in recent upgrades in international credit ratings, lower international and domestic risk premiums, and the strong performance of the Jakarta Stock Exchange.

13 World Bank (2005b), page ii.

and impact of reform, and protecting hard-won gains on fiscal and financial management.

13. There is a complex but close relationship between Indonesia's political and economic development. In some respects, democratisation and decentralisation complicate the task of economic management, while also raising expectations about what government can and should deliver. Indonesians will largely judge the success of this Government by how well it performs in generating jobs and raising incomes, not just in Jakarta or on Java, but throughout the country. Stronger, broad-based growth will help cement the political transition to a democratic system. Equally, failure to improve the investment climate and generate jobs will increase the risks of social unrest and the attractiveness of more authoritarian political regimes and extreme ideologies.¹⁴ Hence the importance of supporting the government's growth agenda and improving development prospects over the next five years, especially in the poorer regions of Indonesia.

THE ROLE OF AID

14. The latest meeting of the Consultative Group for Indonesia (CGI), held in Jakarta on 19 and 20 January 2005, was chaired for the first time by the Government of Indonesia (rather than the World Bank).¹⁵ It confirmed donor support for the government's reform agenda and reconstruction effort in Aceh. Commitments for 2005 totaled US\$5.1 billion, of which US\$3.4 billion was for regular activities and US\$1.7 billion was for Aceh (Table 2). The Government expects to make principal repayments on its external debt of US\$5.5 billion in 2005, leaving a net transfer of US\$0.4 billion to the CGI (before interest payments).

15. The Government revealed at the latest CGI meeting that it intends to reduce the public-debt-to-GDP-ratio to 48 per cent in 2005 and stop foreign borrowing to finance budget deficits by 2009. While this responds to popular concerns about external

debt, it may not be desirable or realistic in light of Indonesia's large requirements for infrastructure etc, and the costs of alternative forms of budget financing. The World Bank projects that the government's gross financing needs will remain around three to four per cent of GDP (US\$11 to US\$12 billion per annum) through 2009, of which an average of US\$4 billion per annum would come from external financing (including export credits). BAPPENAS is preparing a medium-term borrowing strategy to clarify the government's position on future financing requirements and sources, including official loans and grants.

16. The Government also tabled several proposals at the CGI to improve aid effectiveness.¹⁶ It proposed that aid be allocated in line with the priorities of the new medium-term development strategy. It also proposed several measures to improve the implementation of aid-financed projects, including: improved quality of project preparation; more open and honest debate on the policy issues affecting aid-financed programs; a more realistic dialogue with NGOs; improved coordination between donors and with the Government; appropriate standards for controlling corruption and reducing poverty; resolution of on-lending issues; reform of procurement procedures; and greater focus on sustainability of project impacts.

Table 2: CGI pledges for 2005¹⁷ (US\$ billion)

	Regular	Aceh	Total
Budget	2.8	0.7	3.5
Loans	2.6	0.5	3.1
– Program loans	0.9	0.0	0.9
– Project loans	1.7	0.5	2.2
Grants	0.2	0.2	0.4
Off-budget	0.6	1.0	1.6
Total	3.4	1.7	5.1

Source: Soesastro and Adje (2005).

14 Kamala Chandrakirana from the reference group noted: 'Everyday, the average Indonesian has to make a decision as to whether or not support a more open 'liberal' interpretation of Islam or one that is inward looking but more forceful. The fatwa coming out of the national congress of the Indonesian Council of Ulama in August 2005 – that pluralism, secularism and liberalism are against Islamic teachings – is a case in point.'

15 The CGI does not include some newer donors, such as China. China recently agreed to fund US\$7.5 billion worth of energy and infrastructure projects in Indonesia. While these are formally private sector deals, some form of official financing may well be involved.

16 Indrawati (2005c).

17 Disbursement offers for 2005 by CGI members, including Official Development Assistance (ODA) and some non-ODA financing. Pledges include A\$360 million (US\$274 million) from Australia, comprising A\$160 million under the ongoing development cooperation program and A\$200 million under AIPRD (one-fifth of the five-year program). All of AIPRD is shown in the Aceh column, even though it will support programs throughout the country.

CONCLUSION

17. Despite setbacks from time to time, Indonesia has made remarkable progress on restoring political and economic stability since the Asian financial crisis and fall of Soeharto in 1997–98. There is now growing confidence that a democratic and decentralised system can work.¹⁸ And the new Government of President Yudhoyono has raised hopes of more rapid progress on reforms. However, implementation will not be easy. Helping the Government deliver on its promises will be essential – not only for Indonesia's economic future, but also to underpin the transition to a more democratic and stable political system.

18. The success of the current Government will largely be judged by how well it delivers jobs and raises incomes through broad-based economic growth. Accordingly, efforts to improve the investment climate – by reducing corruption, improving the regulatory environment and rebuilding the infrastructure base – are at the top of the government's agenda. But everyone involved in Indonesia's development will have to be realistic about the time it will take to implement reforms and to build credible and effective institutions. The challenge will be to find ways to generate short-term wins and build political support and credibility while sustaining the reform effort over the long haul.

19. While aid is a relatively small part of the overall financing picture, it can play a useful role in reinforcing the government's reform efforts and supporting key poverty-reduction programs. With the addition of the AIPRD, Australia has become the second largest bilateral donor to Indonesia. This provides a special opportunity to contribute to Indonesian development and to strengthen the relationship. The next section will look at how Australia's aid program in Indonesia has evolved in recent years in light of changing development priorities and national interest concerns.

18 While there are still Indonesians who long for the 'good old days' of central control, the balance of opinion among Indonesians and foreigners has shifted over the past two years. Even so, popular opinion could swing again, if democracy fails to deliver economic and social benefits.

3 Australian interests and aid engagement

AUSTRALIAN INTERESTS IN INDONESIA

20. A stable, prosperous, unified and democratic Indonesia is central to Australia's interests in the region, with security and economic interests deepening over recent years.

21. Australia has a stake in helping to reduce poverty and improve the standard of living for the people of Indonesia. This goes beyond the altruistic and humanitarian values as most recently demonstrated by the substantial and immediate assistance following the Tsunami, both from the Australian government and public.

22. The close proximity between Australia and Indonesia presents opportunities for both countries. A growing and prosperous Indonesia represents economic opportunities for Australia while Australia offers a sophisticated market for Indonesian exports and a source of technology transfer and investment. Two-way trade between Australia and Indonesia is close to balanced and reached A\$8.5 billion in 2004, growing at roughly six per cent per annum over the past five years.¹⁹ Australian investment in Indonesia – conservatively estimated at A\$2.1 billion – has been limited by the difficult business environment and need for legal and regulatory reform.²⁰ The conclusion of a new trade and investment framework

proposed by ministers in April 2005 provides a key platform for expanding bilateral economic linkages.

23. This close proximity also presents challenges. Problems in Indonesia can create spillover impacts for Australia. Australia therefore has a vested interest in a well governed and stable Indonesia.

24. Millions of Indonesians dropped below the poverty line, unemployment grew and ethnic tensions were brought to the surface in the wake of the Asian financial crisis in the late 1990s. Instability and communal violence in some areas of the archipelago, separatist movements, terrorist threats, transnational crime, illegal people movement, money laundering, and illicit drug trafficking are security concerns shared by both countries. The Bali, Marriot and Australian Embassy bombings represented a direct threat to Australia's interests and security.

25. HIV/AIDS and potential pandemics such as avian influenza have also emerged as threats to stability and prosperity in Indonesia and pose another dimension to Australia's national interest considerations. A breakdown in delivering services can create disaffection with the move towards democratisation and decentralisation – considered by most as fundamental planks to Indonesia's continuing growth and stability. Recent reports of a polio outbreak in West Java and malnutrition in

19 Source: Department of Foreign Affairs (June 2005), Australia's Trade with East Asia 2004.

20 Source: Austrade.

West Nusa Tenggara potentially undermine public confidence and support for democratisation and decentralisation. More broadly, uneven growth in Indonesia could lead to greater movement of people and increase sources of tension.

EVOLUTION OF AUSTRALIAN AID

26. Australia has been a long-standing supporter of Indonesia's development from the early days of the Colombo Plan in the 1950s. The current program of assistance has been shaped by these recent events:

- > As part of its election platform, the incoming Australian Government abolished in 1997 the commercially-focused Development Import Finance Facility (DIFF).²¹ This was consistent with the move to replace the existing three-pronged objective for the aid program which covered humanitarian, foreign policy and commercial concerns, with one focusing on **advancing the national interest by assisting developing countries to reduce poverty and achieve sustainable development**²². Until then, Australia's aid to Indonesia focused on DIFF, bilateral technical assistance projects in rural development, health, education and a scholarships program.
- > Indonesia's **financial crisis** in 1997–99 exposed fundamental weaknesses in its financial systems and institutions of state. At the same time, *Better Aid for a Better Future* (1998) highlighted a major focus on promoting good governance in the aid program.
- > **East Timor's** independence posed a significant challenge for Australia-Indonesian relations at the time. Australia's aid engagement with the newly independent East Timor did not come at the expense of Australia's aid to Indonesia.
- > The **Bali bombing** in 2002 sharpened Australia's focus on the consequences of instability and terrorism in undermining growth prospects. Australia increased aid to Indonesia by 25 per cent

following the bombing with a focus on counter-terrorism assistance and education initiatives.

- > Indonesia's moves towards **democracy**, culminating in the first direct presidential elections in late 2004, and the decision to **decentralise** government administration and service delivery in 2001, resulted in new requests for assistance from donors.
- > The December 2004 **Indian Ocean Tsunami** brought massive destruction to Aceh in Indonesia. It also heralded a new era of Australia-Indonesia relations with the announcement of the largest single aid package in Australia's history (AIPRD), A\$1 billion over five years on top of the existing annual program of around A\$160 million.

27. In the aftermath of the financial crisis, the Australian aid program assisted Indonesia deal with the social impacts, rebuild the financial system and enhance civil and economic governance while also helping to rebuild the platform for growth. The 2002–2003 strategy sought to contribute to poverty reduction, sustainable economic recovery and democratisation in Indonesia through two main activity streams: addressing the needs of vulnerable communities and promoting improved governance. Six main sectors were identified for AusAID involvement in Indonesia: health, water supply and sanitation, natural resource management and rural development, education and training, governance, and humanitarian relief.

28. The current Country Strategy (from 2003) targets four inter-related objectives:

- I **Improving economic management** through support for accelerated structural reform, including revenue enhancement, financial sector restructuring and supervision and debt management
- II **Supporting the transition to democracy** through assistance for legal and judicial reform, institutions of human rights and public

21 DIFF mixed grant funds with commercial borrowing to offer soft loans for projects initiated by Australian companies in developing countries.

22 The aid program's objective to advance the national interest by assisting developing countries to reduce poverty and achieve sustainable development was articulated by the Minister for Foreign Affairs to Parliament in November 1997. This followed a major external review (the Simons Report) and subsequent policy statement *Better Aid for a Better Future*.

accountability, electoral and parliamentary processes, and civil society

- III **Enhancing security and stability** through support for law enforcement and counter-terrorism capacity building, conflict and disaster prevention, and humanitarian assistance for vulnerable groups
- IV **Increasing the accessibility and quality of basic social services** through policy engagement at the national level and support for planning and implementation at the district level, and support for community-based approaches.

AUSTRALIA-INDONESIA PARTNERSHIP FOR RECONSTRUCTION AND DEVELOPMENT

29. The Australia-Indonesia Partnership for Reconstruction and Development (AIPRD), an A\$1-billion additional aid package announced in the aftermath of Tsunami in early 2005, marked a major change in the bilateral aid partnership.

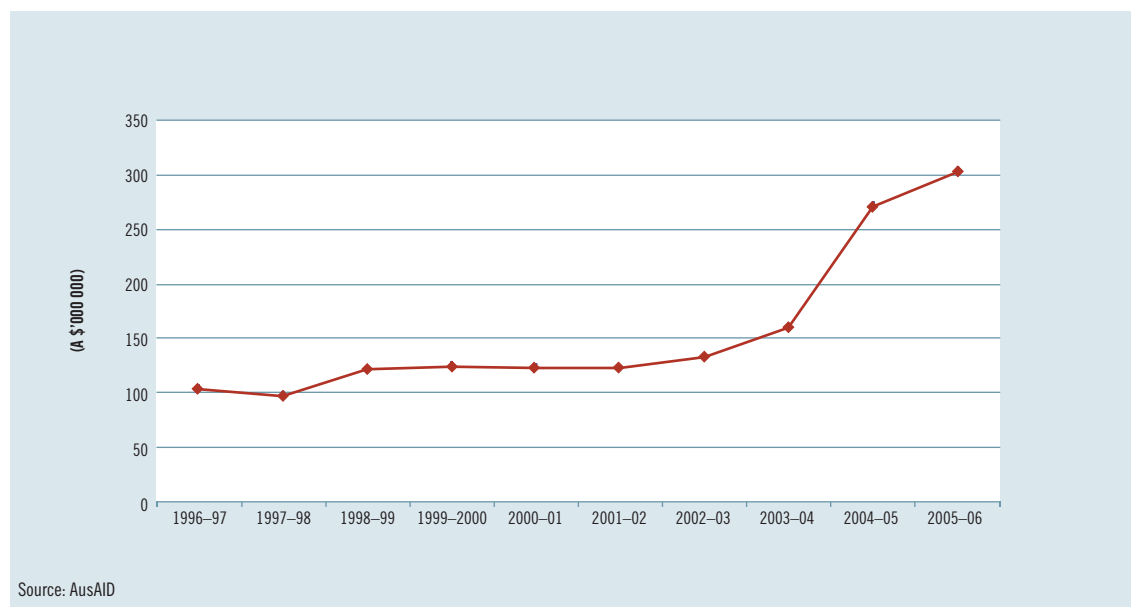
30. The objective of AIPRD is to support Indonesia's reconstruction and development efforts, in and beyond affected areas, through sustained cooperation focused on the GOI's programs of reform and emphasis on economic and social development. It is governed by a Joint Commission, overseen by the Prime Minister of Australia and the President

of Indonesia. The partnership will be implemented according to agreed guiding principles which, *inter alia*, emphasise the joint nature of AIPRD, the need to take account of Indonesia's needs and development efforts, the assistance Australia can provide, and the importance of coordinating activities with international development partners.

31. Under AIPRD, A\$500 million will be provided through a grant assistance program and A\$500 million through a concessional loan program. The A\$1 billion commitment is additional to Australia's existing annual A\$160 million aid program to Indonesia. It is expected that the bulk of AIPRD will focus on:

- > **Promoting broad-based economic growth:** including infrastructure (approximately A\$500 million), economic governance (including a A\$50 million Government Partnerships Fund), private sector development and rural productivity, and human resource development (including 600 additional scholarships)
- > **Emergency preparedness and response:** predominantly Aceh reconstruction but also including responses to other disaster-affected areas (including the Nias earthquake) and efforts to build Indonesia's disaster preparedness and management systems.

Graph 1: Australian ODA to Indonesia, 1996–97 to 2005–06



32. AIPRD has established a new whole-of-government management structure in Canberra. Increased staffing has necessitated the establishment of a separate office in Jakarta. Formal accountability for expenditure under the AIPRD rests with AusAID which is the primary implementing agency for the A\$1 billion package.

33. In volume terms, the advent of AIPRD marks a significant increase in what was an already expanding program (Graph 1 and Annex III).

34. As a proportion of the ongoing aid program, education and governance account for 70 per cent of the program in 2005–06, with health reaching 18 per cent (Graph 2). With the addition of AIPRD, the proportion spent on social and economic infrastructure will increase over the next five years.

AID MODALITIES AND MANAGEMENT

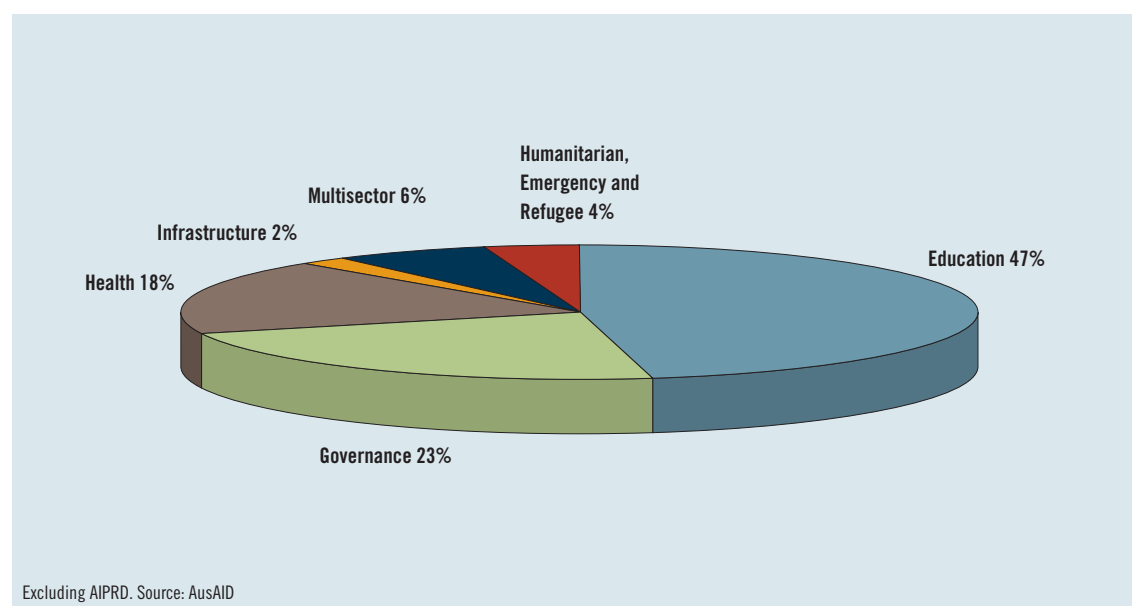
35. A number of initiatives have been introduced in recent years to enhance the effectiveness of the aid program to Indonesia:

- > **Integrated programs.** These have been developed to rationalise and reduce AusAID's involvement in large, stand-alone projects. For example, LAPIS will focus on improving the quality of education of Indonesian Islamic schools. LAPIS will operate initially over five years, with funding of up to

A\$30 million. ANTARA focuses on two of the poorest provinces in Indonesia. This A\$30 million, five-year initiative is a program-based approach, facilitated by partnerships with a wide range of stakeholders within local governments, business communities, civil society organisations, and other donors.

- > **Technical assistance facilities.** The lessons learned from governance assistance to Indonesia since the financial crisis suggested that small-scale, targeted, incremental engagement with strategically important partners worked well. This approach is used in the two governance facilities: the TAMF and the LDF. These facilities are assisted by Advisory Boards, including senior GOI and Australian officials based in Jakarta.
- > **Donor partnerships.** AusAID is strengthening partnerships with other donors in the health sector, including with the Department for International Development (DFID), Germany and UNICEF on maternal and child health and with USAID and DFID on HIV/AIDS. AusAID and the World Bank have also discussed placing an AusAID-funded position within the World Bank's Support Office for Eastern Indonesia, which will serve as a learning and knowledge resource centre to support and facilitate information needs of key

Graph 2: Estimated breakdown of ODA to Indonesia by sector, 2005–06 *



stakeholders on appropriate development models and approaches.

- > **Program management.** As part of implementing AusAID's Strategic Plan, a Minister-Counsellor position has been established in Jakarta. This position is managing the strategic directions of the program, providing overall supervision of program implementation and increasing AusAID's access to senior levels in the Indonesian bureaucracy.

37. The aid program has an increasingly important supporting role in many of these relationships. The newly created Government Partnerships Fund will facilitate greater engagement focusing on economic and financial management and public sector management, and enhance the integration of initiatives. These links are a significant opportunity to bring to bear the experience and technical expertise of a broader range of Australian government agencies not previously engaged substantially with Indonesia.

INTEGRATED WHOLE-OF-GOVERNMENT APPROACH

36. Reflecting the widening and deepening interests and relationship with Indonesia, a broader suite of Australian government agencies are building linkages with their Indonesian counterparts.²³ These include:

- > The Treasury and its portfolio agencies: a recent mission under the Government Partnership Fund mechanism explored possible new partnerships involving agencies such as the Australian Taxation Office (ATO), the Australian Bureau of Statistics (ABS) and the Productivity Commission with their Indonesian counterparts. Treasury has a senior officer posted in Jakarta.
- > Defence cooperation involving non-military and some limited military training.
- > Australian Federal Police (AFP), particularly on counter-terrorism, support for the Jakarta Centre for Law Enforcement Cooperation (JCLEC) as well as ongoing law enforcement cooperation. The AFP has a liaison officer in Jakarta.
- > The Australian Customs Service has ongoing links and is helping to improve border control in the Sulu and Celebes seas region.
- > The Attorney-General's Department maintains ongoing legal cooperation.
- > The Department of Health and Ageing engages in regular high-level dialogue covering issues such as communicable diseases and surveillance.

²³ A series of joint Indonesia and Australian Government working groups operate under the Australia-Indonesia Ministerial Forum. These include groups on health, education and training, agriculture, energy, and trade and investment. Further details can be found on www.dfat.gov.au.

4 Emerging and critical issues

38. The above analysis suggests Indonesia's development prospects and relationship with Australia have changed significantly over the past couple of years. Two clear trends are emerging:

- I Despite periodic setbacks, Indonesia has made remarkable progress on restoring political and economic stability since the Asian financial crisis and fall of Soeharto in 1997–98. There is now growing confidence that a more democratic and decentralised system can work. This has set the stage for significant improvement in the prospects for economic growth and poverty reduction over the medium term, provided the right policies and institutions can be put in place. Even so, Indonesia still faces major challenges to maintain economic and political stability, improve the investment climate and deliver basic social services.
- II There has been a significant improvement in relations with Australia since the tensions over East Timor in 1999–2000. This reflects a growing recognition of Australia's national interest in a stable, prosperous, unified, and democratic Indonesia. Relations have been further enhanced over the past year by the close political ties between the current leaders of the two countries and the close cooperation since the Tsunami

disaster. The AIPRD provides evidence that Australia is willing to back up its commitment with substantial financial assistance.

39. This section examines the emerging and critical issues facing Australian aid in five areas: (a) positioning Australia's aid program; (b) building institutional and human capacity; (c) scaling up the growth agenda; (d) integrating program management; and (e) strengthening partnerships.

POSITIONING AUSTRALIA'S AID PROGRAM

40. The Indonesia program has expanded from seven per cent of Australian ODA in 2001–02 to a projected 12.1 per cent in 2005–06 (see Annex III). This makes Indonesia the third largest recipient of Australian aid after PNG and the Solomon Islands. Australia has also become the second largest bilateral donor to Indonesia after Japan.²⁴ However, whereas Australia accounted for a dominant share of the aid flows to PNG and the Solomon Islands in 2003, it represented only six per cent of the aid flows to Indonesia (Table 3). With the addition of AIPRD, this may now be closer to ten per cent. Even so, this is still a modest amount when compared to the overall population and national income of Indonesia. In this sense, Australia is only a niche player, similar to its

²⁴ Australia's aid program in Indonesia is now slightly bigger than those of Germany and the United States. In addition to Japan, the two major multi-laterals (the World Bank and ADB) also provide substantially more assistance to Indonesia than Australia. Their latest country strategies for Indonesia are set out in World Bank (2003) and ADB (2005). Further details are contained in Annex IV.

Table 3: Australian aid to six countries, 2003²⁵

	A\$ million	A\$ per capita	% of GNI	% of ODA
PNG	321	58	8	95
Solomon Islands	140	305	36	152
East Timor	45	51	8	19
Indonesia	159	0.7	0.1	6
Philippines	49	0.6	0.0	4
Vietnam	74	0.9	0.1	3

Source: AusAID, DAC and World Bank

role in other Asian countries, such as the Philippines and Vietnam.

41. While modest in terms of Indonesia's population and national income, Australia's aid commitment to Indonesia is large by Australian standards and large compared to other bilateral donors. Taken with the deeper and broader Australian Government engagement, being a major donor in a large country is a new position for Australia. On the one hand, Australia will be expected to play more of a leadership role within the donor community than it does in other Asian countries (or than it did in Indonesia in the past). But it will not have the dominant role it plays in PNG or the Solomon Islands. Nor will Australia play a direct or visible role in delivering public services or restoring law and order. Indeed, many approaches adopted in failed or fragile states are not relevant to Indonesia.²⁶ For all its shortcomings, Indonesia is becoming a strong state, which will increasingly see donors as minor partners in development. This has already been signaled by the GOI, which took over the chair of the CGI this year, and projects a declining role for aid financing over the medium term.

42. The Australian aid program in Indonesia will have to be carefully positioned to reflect these realities. The GOI will want a major say in how additional funds under AIPRD are to be spent (even though it may lack the capacity to respond quickly to Australian proposals). Other donors will want to

partner with Australia, pooling resources around common goals and leveraging Australia's leadership role in some areas (such as Eastern Indonesia, legal reform, maternal and child health, and HIV/AIDS). At the same time, Australian politicians and officials will be expecting a high profile and will want to see solid returns on their A\$1 billion investment. Marrying these viewpoints will be a major challenge facing the Australian aid program in Indonesia over the medium term.

43. Another challenge will be maintaining momentum in the face of unexpected developments and setbacks such as:

- > Natural disasters, including the Tsunami in Aceh and earthquake in Nias, will be a recurring reality – hence the importance of work on emergency preparedness and response under AIPRD. The overall aid program will also have to maintain flexibility to respond quickly and effectively to emergencies.
- > The bombing of the Australian Embassy last year placed extra strains on the aid program and these strains were compounded by the very significant aid program response to the Tsunami. Further, AusAID staff have had to move into temporary offices where they work in cramped conditions without natural light. While staff morale remains high, frequent travel warnings and bomb threats are clearly an ongoing concern for staff.

²⁵ Australian aid numbers are gross expenses for 2003–04 from Downer (2005). ODA numbers for 2003 are from DAC and are net of principal repayments. Hence the ratio of Australian aid to ODA can exceed 100 per cent (as in the Solomon Islands).

²⁶ Indonesia was ranked borderline (46 out of 60 countries) in a recent index of failed states (Fund for Peace and Carnegie Endowment for International Peace, 2005). Some characteristics of fragile states – insecurity, poor governance and weak implementation capacity – are evident in parts of the country. For a review of development initiatives in fragile states, see Lotz (2005).

> Public opinion in Australia also wavers on Indonesia, as during the recent court case of Schapelle Corby.²⁷ More legitimate concerns may be raised when Australian companies suffer from corrupt or incompetent court cases in Indonesia. As at the time of the tensions in East Timor, the Australian Government will have to carefully and constantly explain its national interests in Indonesia to the public and protect the aid program from unjustified swings in support.

44. A related issue is the timeframe of Australia's expanded engagement in Indonesia. AIPRD is a five-year program, which largely mirrors the term of President Yudhoyono's government. It is perhaps too early to decide whether this commitment will continue beyond 2009. A great deal will depend on how successfully AIPRD meets its objectives, and how Indonesia develops politically and economically. But this decision should not be postponed too long. Expectations will start to develop about the type of role Australia will play in the donor community. And it would be unwise to signal a cut back in Australian support during an election year in Indonesia. Some kind of transition strategy should be put in place well before 2009. As argued below, this should probably involve closer integration between AIPRD and the already existing AIDCP.

BUILDING INSTITUTIONAL AND HUMAN CAPACITY

45. Australia has developed a reputation as a responsive and flexible partner in Indonesia. While AusAID has largely funded its own bilateral aid projects, it has also been willing to support the initiatives of other donors when it is seen to make sense. Australia has also responded quickly and generously in times of need, as demonstrated by the Tsunami relief and reconstruction effort. Such ad hoc initiatives have inevitably delayed implementation of longer-term programs to build institutional and human capacity. However, as foreseen in the Country

Strategy, these are expected to play a more central role in the years ahead. Recent initiatives in three areas – governance, human resource development, and regional development and decentralisation – provide examples of how Australian aid can support capacity building in Indonesia. Suggestions on future development of these programs are provided here.

a) Governance

46. The Asian financial crisis exposed major weaknesses in Indonesia's institutions of economic and political governance. Australia's immediate response focused on improving social monitoring and safety nets. A recent evaluation rated Australia's support to the Social Monitoring and Early Response Unit (SMERU) and the Back to School Program as highly successful.²⁸ Other initiatives to improve basic data and information systems were rated as successful. These initial efforts have been supplemented by longer-run technical assistance, designed to address governance concerns in economic management, justice and legal reform, political governance, and transnational crime.²⁹

47. **Economic management.** Australia has a good reputation, backed up by evaluation results, for delivering top-notch expertise in many areas of economic management, while also adapting to local conditions. Assistance to date has focused on strengthening debt management, bank supervision, tax administration, and anti-money laundering capacity. Most of this support has been provided under the TAMF. TAMF III, established in April 2004, is structured around three core pillars: (a) promoting fiscal sustainability; (b) protecting the government's financial position; and (c) strengthening the financial sector. An extension of TAMF's mandate to cover trade policy and infrastructure is under consideration (paragraphs 64 and 65).

48. The Government Partnerships Fund under AIPRD provides opportunity to scale up support for

27 For an excellent commentary on the legal aspects of the case, and the public reaction, see Tim Lindsey's article in the Melbourne Age, 28 May 2005.

28 Stoekel (2003). A separate review of AusAID funding for SMERU by Hal Hill (2003) reached similar conclusions.

29 For a critical assessment of AusAID's governance program in Indonesia, see Forrester (2005). Forrester concludes that three key ingredients are needed for success: (a) commitment of adequate time and resources to achieve a sustainable result; (b) the right people with the right knowledge in AusAID and among its contractors and sub-contractors; and (c) proper diagnosis of development problems and their causes, so aid is not wasted. Many of these conclusions reflect improvements already underway.

economic management and public sector reform, while improving coordination of separate technical assistance activities by different government departments.³⁰ Feedback from the authors' visit to Jakarta suggests that GOI officials welcome this type of support, provided technical advisers can respond flexibly to Indonesian priorities and work effectively within the Indonesian system. Attention should be given to building up the knowledge base on development issues at national and regional/local levels. Careful coordination between TAMF and the Government Partnerships Fund will be needed to avoid duplication of efforts and to ensure technical assistance is delivered in a timely and efficient manner.

49. Justice and legal reform. The LDF aims to strengthen the capacity of Indonesian government institutions and civil society to promote legal reform as well as protect human rights.³¹ It includes a core program of longer-term activities with strategic partner agencies (including the Supreme Court and the National Human Rights Commission) and a flexible funding component to address immediate and emerging issues through smaller, short-term activities. Feedback from the visit to Jakarta suggests this support is appreciated by proponents of legal reform – both Indonesians and others in the donor community. This may be an area where Australia could play more of a leadership role.³² It must be recognised however that patience and persistence will be needed to convert these efforts into sustainable results. A long-term view of what can be achieved, and how to build support for legal reform, is therefore required.

50. Political governance. A sound legal and judicial system is essential to underpin good political governance. Australia has also supported the democratic process directly through assistance for national elections in 1999 and 2004. Beginning in 2005, Indonesia began holding direct popular elections for provincial governor, district head

and municipal mayor positions. Australia will provide assistance for this process of local-level democratisation through a coalition of Indonesian organisations known as the People's Network for Voter Education. A new one-year program of cooperation with Indonesia's newly-formed DPD began in December 2004. This program, managed by the International Institute for Democracy and Electoral Assistance (IIDEA), will support the DPD in conducting its constitutional functions related to legislation, oversight and regional representation. GOI is also keen for Australia to support the legislative unit in Parliament, including in legal drafting and the legislative process, and in providing direct support to Parliamentary Committees in the form of full-time professional advisors.

51. Good political governance also requires strong civil society participation to ensure that politicians and bureaucrats are held accountable, especially for delivering public services. This is especially important in a country like Indonesia, where corruption is widespread and formal institutions of accountability are still weak. In turn, civil society organisations need support to build their own capacity for leadership, management and accountability. Australian aid could help by funding Indonesian or international NGOs with a proven track record in this area, possibly as part of its regional development programs (paragraphs 57 to 62).

52. A series of exchanges between politicians in Australia and Indonesia is being organised by the Centre for Democratic Institutions (CDI). These include seminars on Parliamentary Oversight of Treaties and an Indonesian Political Parties Study Program. Such contacts can help build mutual understanding and possibly lead to valuable opportunities for capacity building in Indonesia's immature democratic institutions.

53. Transnational crime. Australia's approach to counter-terrorism recognises that 'poverty, conflict and weak governance create environments for the

30 The DAC (2004) review of Australian aid noted (page 6): 'While there is undoubtedly a place for other government agencies in the delivery of aid, this carries risks if these agencies are involved without any requirement to include development objectives (sustainability, capacity building and local ownership) in their strategic plans and their performance monitoring and reporting systems'. DAC recommended that AusAID should play a lead policy-making role in relations with partner developing countries.

31 A broader umbrella is provided by the Working Group on Legal Cooperation (WGLC), co-chaired by the Department of Foreign Affairs in Indonesia and the Attorney-General's Department in Australia. The WGLC provides a forum for promoting greater understanding of each country's laws and legal systems, and sharing information on legal cooperation activities.

32 The CGI Working Group on Justice and Legal Reform is co-chaired by BAPPENAS and the Netherlands, with support from the World Bank. Australia is a member of the Working Group and could be a co-chair in the future.

growth of terrorist networks' (AusAID, 2003b). In this sense, all aid efforts directed at improving governance and reducing poverty can be seen as contributing to the fight against terrorism. Terrorism also impacts on poverty by destroying lives and property, by threatening personal security and by undermining prospects for economic growth (as was seen in the case of the Bali bombing). These same arguments can be extended to other transnational crimes, including drug and people smuggling. Therefore, to the extent that Australia's assistance to Indonesia can help reduce transnational crime, including terrorism, it is mutually beneficial to both countries.

54. In October 2002, Australia announced an A\$10 million commitment over four years to assist Indonesia to build its counter-terrorism capacity. This covered three broad areas of support: (a) building the capacity of the national police on counter-terrorism and transnational crime; (b) restricting the flow of financing to terrorists; and (c) enhancing travel security. In December 2004, this commitment was doubled to A\$20 million over five years. These additional funds will be used to support emerging transnational crime priorities, including for counter-terrorism, that do not clearly fall within the mandate of other Australian government agencies. This is consistent with the whole-of-government philosophy and frees funds for high-impact initiatives over the next five years. AusAID is considering setting up a program facility, along the lines of TAMF and LDF, to manage this package of activities.

b) Human resource development

55. **Health.** Recent reports of polio, malnutrition and avian influenza in parts of Indonesia have underlined the importance of maintaining basic health services. Australia has played a leading role in the health sector, especially in supporting programs for maternal and child health, HIV/AIDS and other communicable diseases. Other donors are now interested in working with AusAID to expand these programs:

- > Under a new partnership, DFID will provide funding to UNICEF to extend an existing AusAID-UNICEF program for **maternal and child**

health. AusAID will, with funding from DFID, undertake the monitoring and evaluation function for the entire program. In addition, separate discussions between AusAID and UNICEF are exploring ways to better leverage this collaboration to have greater policy engagement at the national level. It is intended that this partnership will extend to AusAID contributing to UNICEF's next Country Strategy for Indonesia (2006–10).

- > Key donors, particularly Australia, the United States and the United Kingdom, have agreed on a framework for an **HIV/AIDS Partnership Program** designed to upscale the HIV/AIDS response in Indonesia. In particular, DFID will provide additional funds to AusAID to significantly expand its HIV/AIDS activities in Indonesia and enhance their impact. The partnership program should support the roll out of provincial HIV/AIDS strategies and stronger leadership by civil society and the national government in mounting a coordinated, multi-sectoral response, which engages not just the health sector, but crucially justice, corrections and police in ensuring there is a supportive context for targeted prevention work with injecting drug users and sex workers. AusAID is also supporting regional cooperation on HIV/AIDS through the South West Pacific dialogue.
- > Australia has initiated a new A\$3 million partnership with WHO to support emergency responses to **communicable disease outbreaks** in Indonesia. This will strengthen monitoring and surveillance systems, and build long-term local capacity to prepare for and respond to future outbreaks. Through the partnership, Australia has already partly funded the WHO's response to the Indian Ocean disaster and avian influenza outbreaks. Over time, AusAID is interested in extending its work on communicable diseases to look more closely at causes and prevention.

56. **Education** accounts for almost half of AusAID's assistance to Indonesia, encompassing a wide range of activities from basic to higher education. A significant scaling up of activities is planned under AIPRD, including for technical and vocational training. A number of ongoing programs provide a

solid foundation for AusAID's future activities in the education sector, including:

- > Australia provides about A\$30 million per annum through its development cooperation program to improve the management and delivery of **basic education services**. Although positive results have been seen from the Primary Education Partnership in NTT, such activities have suffered from the lack of a clear strategic plan from the Ministry of National Education for improving the quality and access to basic education. The Ministry is developing a strategic plan for education and donors are considering a coordinated approach to address sector-wide issues. AusAID should actively participate in this process, while maintaining its bilateral programs where they are shown to be delivering results.
- > Islamic schools provide a vital role in helping Indonesians overcome the disadvantages of poverty and remoteness, and providing basic education for girls. Many Indonesian families also want a strong religious foundation for their children's education, yet the vast majority of madrasah schools do not meet fundamental quality standards in terms of inputs, processes and outcomes. The LAPIS is intended to address these concerns, initially focusing on clusters of madrasah in three or four local districts. School-level activities will be supplemented by district or even provincial level support for teacher development and the provision of learning materials. A great deal of effort has gone into setting up a demand-driven process for selecting priorities. This approach won praise from others involved in Islamic education.³³ Indeed, ADB is likely to draw on AusAID's expertise for developing its own programs in the sub-sector.
- > **Australian Development Scholarships** have played a significant role in Australia's aid program, providing more than 8000 scholarships since the early 1950s. The current phase of ADS has

adopted a targeted approach, whereby awards are allocated to candidates from agencies involved with AusAID programs. In addition, at least 30 per cent of all scholarships are awarded to candidates from Eastern Indonesia, AusAID's geographic focus. Under AIPRD, the scholarship program is to be expanded from 300 to 600 per annum for the next two years. This should be an opportunity to rethink the allocation criteria. More attention should be on developing future leaders and reformers from the public and private sectors and from all areas of Indonesia. A strong ADS alumnus would help build mutual understanding between the two countries in the years ahead.

- > **The Specialised Training Program** to Indonesia was established in 1994 and is now the key mechanism for delivering training to government, private sector and community institutions through Indonesian and Australian training providers. The STP has been assessed as effective – it is needs-driven, encourages and supports trainees to promote their skills and knowledge in their workplaces, and uses mentors to enhance institutional ownership and sustainability. Under AIPRD, Australia will prepare an analysis of skills development and training needs in Indonesia, closely linked to the country's employment and growth objectives. This will provide a platform for an expanded program of Australian assistance over the next five years.

c) Regional development and decentralisation

57. It is important that Indonesia's development brings economic and social benefits to all parts of the country, especially poorer regions. This will help build a more stable and unified country, and ensure the poor have a stake in development. Decentralisation provides opportunities and challenges for supporting regional development.

58. Australia's traditional focus on **Eastern Indonesia** has been justified by the high poverty rates and poor

³³ Asyumadi Azra, Rector of the State Islamic University of Jakarta, recently commended Australia's involvement in LAPIS (Republika, 3 June 2005). He noted: 'Some may suspect Australia has a "secularisation" interest. I can assure you this is not so. They work in genuine partnership with Islamic education and civil society organisations such as us, and genuinely heed our advice and respond to real needs'.

social conditions in this region.³⁴ This region is strategically important because of its close proximity to Australia.³⁵ Over the years, Australia has developed considerable knowledge and experience in the development challenges facing Eastern Indonesia.³⁶ However, past efforts to address these through ad hoc sectoral projects have not succeeded. Instead, AusAID is shifting to a more integrated approach under the ANTARA program. The program's goal is to reduce poverty in NTT and NTB through sustainable and equitable social and economic development by improving: (a) provincial and district governance; (b) peri-urban and rural income; and (c) access to and quality of basic services. The program director will be located in Kupang. Opportunities under ANTARA to strengthen the knowledge base on local development issues (for example, through a SMERU-type institute), to support reformers in local government, and to encourage NGO and media monitoring of public performance should be explored.

59. The region of Papua occupies a special place in Indonesia.³⁷ It is the country's easternmost, largest and most sparsely populated province. Ever since its controversial integration into Indonesia in 1969, the region has been troubled by separatist movements and social unrest. Following Indonesia's political transition in the late 1990s, the Special Autonomy Law for Papua was passed in 2001, aimed at solving ongoing conflict and accelerating economic development. The special autonomy status carried with it an increased flow of resources to Papua. Yet, as history shows, economic growth and fiscal wealth alone will not solve Papua's problems. Despite substantial natural resources, 40 per cent of Papuans still live below the poverty line, and one-third of children do not go to school. Nine out of ten villages do not have basic health services.

60. Australia has an interest in ensuring Papua develops into a stable and prosperous region. AusAID has a number of ongoing programs in

Papua, working on HIV/AIDS, maternal and child health, and local governance. AusAID also followed closely the recent public expenditure review carried out by the World Bank and the provincial government, in association with three local universities and civil society groups. This review covered the province and four districts, and will be followed up with support for the ongoing budget planning, allocation and review process in these areas. The objective is to improve the overall quality and efficiency of public expenditure management. This may lead to further opportunities for AusAID to support policy dialogue and capacity building in the region. Given the sensitivities involved, a multi-stakeholder approach makes sense.

61. AusAID's geographic focus on Eastern Indonesia is likely to be diluted by the reconstruction effort in Aceh, the enhanced support for national programs under AIPRD, and by growing support for basic and Islamic education which will be Java based. This is appropriate and should be reflected in the updated Country Strategy. While it is early days, and it will take time to get the program running, the integrated approach being pioneered under ANTARA may prove suitable for AusAID's activities in other regions. More generally, Australia should continue to support **decentralisation**. While the framework is still not perfect, it is time to shift the focus to: (a) redefining the role of central government, including setting and monitoring standards for service delivery; and (b) finding ways to fund and implement effective programs at local government level. For example, some see the recent outbreaks of polio and malnutrition as symptomatic of the breakdown of health services under decentralisation. The GOI proposes to reintroduce targeted grants (DAK) to address these concerns. These may be a vehicle for donor funding.

62. Other donors struggle with similar issues of fiscal relations and program delivery under the decentralised system of administration. A new

34 Although many more poor people live on Java. This tension between absolute and relative poverty is a constant challenge to setting development priorities for both the GOI and the donor community.

35 In the past, there has been sensitivity within Indonesia over Australia's strategic interest in Eastern Indonesia, given separatist movements in East Timor and Papua, and the larger proportion of Christians living in the region. LAPIS provides an important counterbalance on the religious focus of Australia's aid program.

36 See, for example, Jones and Raharjo editors (1995).

37 The analysis on Papua is drawn from World Bank, SOFEI, Pemerintah Provinsi Papua (2005).

Decentralisation Support Facility (DSF), managed by the World Bank and funded by a number of donors including DFID, has been established in Jakarta to collect and share information on decentralisation, and to tackle emerging issues in a coordinated way. AusAID may want to participate, contributing its knowledge from ANTARA and learning from the experience of others. Initial steps have been taken to fund a position within the World Bank's Support Office for Eastern Indonesia and to co-finance IFC's Program for SME Assistance in Eastern Indonesia (PENSA). Likewise, other donors may want to contribute to AusAID's Kupang office.

SCALING UP THE GROWTH AGENDA

63. While initially motivated by reconstruction in Aceh, AIPRD also provides great opportunity for Australia to step up its support for economic growth in Indonesia. Higher, sustained economic growth is essential to create jobs and reduce poverty. There is now broad consensus around what is needed to support economic growth, from short-term macroeconomic stability to long-term improvements in economic governance and institutional capacity.³⁸ The current aid program is active in both areas. But there is more that can be done to fill in the middle ground on the development agenda – to give a much-needed boost to economic growth over the next five years. Three areas stand out for AIPRD support: (a) trade and investment policy; (b) infrastructure development; and (c) agriculture and rural development. In all these areas, further analysis on major constraints to growth, at the national and regional level, could help identify priorities for policy reform and Australian assistance.³⁹

a) Trade and investment policy

64. The uncertain regulatory environment in Indonesia is cited as one of the main concerns

of investors.⁴⁰ Firms now spend about ten per cent of their time each week completing forms and dealing with other regulatory requirements. The Minister of Trade is aware of the costs this regulatory burden imposes on firms, and is keen to establish review mechanisms that reflect the wider interests of investors and consumers. The Australian Productivity Commission could provide relevant experience. The Minister for Trade has been tasked with working on the new investment law by the Coordinating Minister for the Economy. The draft is due to be finalised soon with implementation resting with BKPM and like agencies. The Trade Minister wants to strengthen the Ministry's capacity to review domestic trade restrictions and participate in global, regional and bilateral trade negotiations. AusAID responded quickly by extending TAMF's mandate to include a new pillar on trade policy, and by appointing an AusAID-funded adviser to the Minister. This adviser should work closely with the proposed World Bank review of the Ministry's role and functions, to identify further opportunities for technical assistance. The Minister is also keen to take advantage of the expanded scholarship program to upgrade the skills of younger, promising staff. In addition, Australia is seeking to conclude with Indonesia a new Trade and Investment Framework, which will provide a mechanism for closer cooperation and policy dialogue with Indonesia.

b) Infrastructure development

65. There is now growing recognition that infrastructure can reduce poverty by supporting economic growth and the delivery of social services.⁴¹ After the financial crisis, Indonesia severely cut back its public investment program in infrastructure, and the private sector was scared off by failed deals and corruption.⁴² As a result, major infrastructure gaps have emerged, especially for power, water supply and roads. The new government of President

38 For lessons from the growth experience of the 1990s, see World Bank (2005g). This review confirms the importance of fundamental principles: macro stability, market forces governing the allocation of resources, openness, and the sharing of the benefits of growth. At the same time, it confirms that these principles translate into diverse policy and institutional paths, implying that economic policies must be country specific and institutionally sensitive if they are to be effective.

39 A great deal of analysis has been completed by the World Bank and others on the overall investment climate and prospects for growth (references attached). However, there are still important gaps – for example on how to get the rural economy moving and attract private investment in poorer regions, such as Eastern Indonesia. These are areas where Australian expertise could be used.

40 World Bank (2005b).

41 See ADB, JBIC and World Bank (2005) for a review of East Asia's experience with infrastructure development, and its contribution to growth, service delivery and poverty reduction.

42 See World Bank (2004a) for a review of Indonesia's infrastructure challenges and policy issues.

Yudhoyono has made infrastructure development a top priority and kicked off its drive for more private participation at the Infrastructure Summit in January 2005. However, more work remains to provide a sound policy and regulatory environment for infrastructure development. To speed up reforms, the minister-level KKPPI has been reconstituted, with additional decision making powers. Again, AusAID responded quickly by expanding the TAMF mandate to include a pillar on infrastructure development, and by appointing an infrastructure adviser to KKPPI. Australian experience with public-private partnerships in infrastructure development – especially on tariffs, subsidies and competition policy – is likely to be relevant to Indonesia's current policy choices.

66. AIPRD provides an opportunity to augment the policy work under TAMF with financial support for infrastructure development. The A\$500-million loan component of AIPRD has been allocated predominantly to infrastructure projects, along with additional grant aid to design, supervise and monitor these projects. While specific projects are yet to be identified, it is expected these funds will be used for economic and social infrastructure. Given the expected difficulties of setting up and managing free-standing projects, Australia is looking at collaborating with existing or planned infrastructure programs, including World Bank financed projects for national roads, water supply and local market access. This will simplify the task of establishing disbursement and monitoring mechanisms, including on-lending arrangements with local governments. Even so, it would be unrealistic to expect that these funds will disburse quickly.⁴³ Concerns on environmental and social impacts, as well as the risks of corruption, will have to be addressed. Care should also be taken to ensure that large infrastructure projects do not distort or circumvent demand-driven processes built into

existing programs, especially in social sectors (for example, LAPIS).

c) Agriculture and rural development

67. AusAID's Country Strategy for Indonesia identifies agriculture and rural development as one of five priorities for poverty reduction (Box 1). This reflects the predominantly rural nature of poverty in Indonesia. The strategy concludes that the main elements of a renewed push on agriculture and rural development should centre on agricultural research, rural extension services, reduced post-harvest crop loss rates, improved rural infrastructure, improved productivity in the smallholder tree crop industry, and expanded access to rural credit, including micro-credit programs. The GOI announced its own strategy to revitalise the agriculture, fishery and forestry sectors on 11 June 2005, although it is short on detail at this stage and the Government's openness to foreign assistance in these sectors is still unclear. Even so, AIPRD has tentatively allocated A\$50 million for private sector development and rural productivity. Australia has extensive knowledge and experience to offer on agricultural issues, especially in Eastern Indonesia, and could potentially make a major contribution in the future.⁴⁴ One challenge will be to look beyond agriculture at the needs for rural infrastructure and off-farm employment,⁴⁵ the implications for natural resource management (including land, water and forests). Concerns about illegal fishing also need to be addressed.⁴⁶

INTEGRATING PROGRAM MANAGEMENT

68. AusAID's decision to shift strategic management of the Indonesia program to Jakarta is sound. It has enhanced AusAID's stature with the GOI and within the local donor community, and facilitated

43 The World Bank loans typically take 18 months to three years from original concept to become effective, and another three to five years to disburse. Multilateral agencies like the World Bank and ADB cannot co-finance with tied loans, but some form of parallel financing, preserving the Australian brand, should be possible.

44 For example, ACIAR's Indonesia program is expected to reach A\$5.2 million in 2005–06. It has strong emphasis on agricultural research interventions to increase farmer and fisherfolk incomes, especially in Eastern Indonesia. In 2005, following the Tsunami, ACIAR commenced training and technical projects to assist fisheries and agricultural rehabilitation in North Sumatra and Aceh.

45 Improvements in agricultural productivity tend to shed rather than absorb labour. Recent reports by BPS suggest that manufacturing employment in rural areas rose from 1.84 million in 2003 to 2.07 million in 2004 (*Jakarta Post*, 22 June 2005). It would be worth exploring the reasons for this growth and constraints on expanding off-farm employment.

46 Illegal fishing is a growing bilateral concern that Australia is seeking to manage cooperatively with Indonesia. Australia will seek to strengthen Indonesia's capacity to manage domestic fisheries. There is scope for this to be implemented through the Government Partnership Fund.

rapid response when needed, as at the time of the Tsunami. The priority now is to integrate program management, within the ongoing development cooperation program and with AIPRD.

69. A new management structure for AusAID programs in Indonesia is being considered. This could involve the appointment of cluster leaders to oversee AusAID's activities in key areas, such as Islamic education, general education, maternal and child health, HIV/AIDS, economic governance, and legal reform. These leaders would help provide strategic direction and coordination to program development, stronger oversight and guidance to project contractors, and also be well positioned to develop partnerships with other donors (paragraphs 72 to 74). Some consolidation of program management along these lines is warranted.⁴⁷ But a great deal will depend on the calibre of people attracted to these positions, from inside or outside of AusAID. Care will be needed to avoid overlapping responsibilities between layers of program and project management in Jakarta and Canberra.

70. Similar efforts are underway to coordinate management between the existing development cooperation program and AIPRD. A working arrangement is in place to align similar programs. For example, the development cooperation program will coordinate technical assistance under the Government Partnerships Fund and the TAMF and LDF facilities, while AIPRD will coordinate scholarship programs. It was evident at the time of the authors' visit to Jakarta that this was causing some confusion within the GOI and the donor community. This should diminish over time particularly with the expected release of a partnership framework between the two governments. The cost efficiency of running two aid offices (pursued because of logistical reasons) and management structures should also be looked at carefully. Moves to integrate the programs under one common set of objectives, a single management structure

and a performance measurement framework are supported.

71. AIPRD reintroduced tied loans to Australia's aid program in Indonesia for the first time since the DIFF mixed grant funds were abolished in 1997. For the longer term, the experience with tied loans should be reviewed. Initial indications suggest these will complicate the task of disbursing funds, in part because Indonesia's demand for loans is changing. A move back to an equivalent all-grant program would probably make sense over the longer term.

STRENGTHENING PARTNERSHIPS

72. The above review confirms there are ample opportunities for Australia to strengthen its **partnerships with other donors**. This is already happening in many areas, including through recent initiatives on Eastern Indonesia, maternal and child health, and HIV/AIDS. However, the expanded scale of Australia's aid program means partnerships will have to be pursued more proactively. Collaboration with other donor programs will be important in achieving speedy and effective implementation of a large, new program such as AIPRD. By building on the analytical and implementation frameworks already established by other donors, such as the World Bank for infrastructure development, new activities can be prepared relatively quickly, with minimal additional burden on Indonesian government structures. Similar arguments in favour of partnerships apply in supporting national programs for public sector reform, where leadership is likely to come from multilateral agencies (World Bank, ADB, IMF etc).⁴⁸

73. There may also be occasions where Australia wants to participate in sector-wide approaches to improve the coordination of aid, for example on education, health and decentralisation. In all these areas there will be opportunities for Australian leadership – because of the growing size of

47 In the past, the AusAID program was dominated by fragmented projects run by contractors. There has been effort in recent years to consolidate projects into facilities and programs. But AusAID guidance and oversight of program and project contractors is still required. Furthermore, other Australian Government departments that provide technical assistance often rely on AusAID's support for government access and field administration. This is easier within consolidated programs.

48 Past efforts at systemic public sector reforms (including civil service salaries, staffing and incentives) have usually failed for lack of GOI leadership. Efforts to improve the performance of individual public institutions have sometimes been more successful (for example, the Large Taxpayer Office). Bilateral donors, such as Australia, can help establish 'islands of excellence' at the national and local levels. But, ultimately, these will run into systemic constraints, which can only be tackled through higher-level policy dialogue, which is the comparative advantage of multilateral agencies.

Australia's program and AusAID's track record of successful, innovative projects. The same applies to legal reform and possibly security and development. This leadership role will inevitably raise Australia's profile within the donor community and with the GOI. With a higher profile, Australia can also ensure its support is acknowledged and branded. Other donors, including the Dutch and DFID, have achieved this while also influencing the strategies and programs of other donors.⁴⁹

74. In most developing countries where donor coordination and partnerships have worked well (for example, Vietnam and Uganda), the host government has provided strong leadership. The GOI has signaled its desire to provide leadership by taking over the CGI chair. But, with the notable exception of the Aceh reconstruction effort, this is still to translate into effective day-to-day coordination of aid relationships. BAPPENAS used to play a central role this way and technical assistance to help it regain this capacity would be welcome by all donors.

75. While partnerships with other donors are important, Australia should endeavour to reach out to a **broad range of partners** in Indonesian development. This is much in line with the people-to-people linkages envisioned under AIPRD. Good examples already exist, such as the partnership with the Asia Foundation on voter education for the national and local elections.⁵⁰ But similar opportunities to partner with foundations, civil society groups and academics, from Indonesia and Australia, exist throughout the aid program.⁵¹ These should be explored, not only for their own merit but as ways to improve effective delivery of aid. Particular attention should be given to strengthening analytical and research work on Indonesian development issues, and making better use of civil society groups in program delivery and monitoring.

76. More broadly, there is an opportunity to strengthen enduring linkages with current and future leaders in Indonesia and Australia – across government, politics, religion, business, and media. Exchanges between parliamentarians and political parties organised by the CDI, and mentioned earlier (paragraph 52), are one example. Similar exchanges and partnerships between politicians at the local level should also be explored. AusAID supported the International Dialogue on Interfaith Cooperation held in Indonesia in December 2004, for example, and the Australia-Indonesia Institute has organised a number of Muslim exchanges. Such people-to-people activities help build mutual understanding, while providing valuable opportunities for learning and capacity building in Indonesia.

49 DFID's program in Indonesia was restructured during 2004 around two priorities: (a) development effectiveness through harmonisation; and (b) improving performance on off-track MDGs. The first priority focuses on decentralisation and support to local service provision through the joint DSF. The second priority provides support through partners (including AusAID) to address maternal mortality, TB and HIV/AIDS. DFID believes it has influenced and strengthened the capacities of multilateral partners (World Bank, ADB and the UN) to better design and target their interventions and influence key policy areas and processes for poverty reduction.

50 The Asia Foundation also does interesting work with Islamic and women's groups, and on human rights, conflict management, and local governance.

51 During the authors' visit to Jakarta, a number of Indonesians commented that Australian NGOs used to be more active in the past. Some may have lost their rationale with the fall of the Soeharto regime, while concerns about the political motives of others may have curtailed their activities. However, the Aceh reconstruction effort has provided a new opportunity for Australian NGOs to establish their development credentials, and some may decide to stay on and expand their activities to other parts of Indonesia.

5 Conclusions

77. Despite setbacks from the recent Tsunami and regular terrorist threats, there is growing confidence in Indonesia that a democratic and decentralised system can work. This confidence has been bolstered by the successful elections last year and signs of a pick up in investment and economic growth. Economic management remains sound and the new Government has shown encouraging signs of a readiness to tackle corruption. There is also evidence of more effective local administration in a number of provinces and districts.

78. Even so, economic growth remains well below the levels needed to provide enough jobs, especially for the poor and young, and to keep pace with the Asian giants of China and India. The investment climate is still very weak compared to other countries in the region and there are troubling signs of a breakdown in basic health services, with recent reports of polio, malnutrition and avian influenza in some areas. If not well handled, these developments could undermine support for the Government and the democratic process.

79. Australia has a strong national interest in a stable, prosperous, unified, and democratic Indonesia. To meet this objective in a rapidly changing political and economic environment, the aid program has evolved in a responsive and flexible way over the past five years. AusAID played a useful role in helping the country overcome short-term threats from the 1997 financial crisis and the recent Tsunami. It is also supporting longer-term programs

to improve governance, and deliver better education and health services. With the addition of AIPRD, Australia has signaled a growing commitment to Indonesian development.

80. Looking forward, this paper identifies strategic issues that will help shape the Indonesia program over the medium term:

- > The ongoing development cooperation is increasingly focusing on building institutional and human capacity. This is appropriate – indeed essential to provide a solid base for sustained reform and growth over the medium term. AusAID is now supporting innovative programs (including LDP, LAPIS and ANTARA) that will take time to implement but with patient and persistent efforts will promise good results. Special attention should continue to be given to poorer regions, such as Eastern Indonesia, so benefits of growth are widely shared throughout the country.
- > However, the Indonesian people will demand quicker returns from the transition to a democratic and decentralised political system. AIPRD provides an opportunity to support government efforts to raise growth and create jobs over the next five years. This means tackling weaknesses in the investment climate, removing infrastructure bottlenecks, and improving the environment for agriculture and rural development. In all these areas, further analysis on the major constraints to growth, at the national

and regional levels, could help identify priorities for policy reform and Australian assistance.

- > AusAID's decision to shift strategic management of the Indonesian program to Jakarta is sound. The priority now is to integrate program management – between staff in Jakarta and Canberra, between clusters of activities within the ongoing development program and with AIPRD. The moves to integrate the programs under one common set of objectives, a single management structure and a performance measurement framework are supported. The experience with the loan component of AIPRD should also be reviewed. A move back to an equivalent all-grant program would probably make sense over the longer term.
- > Australia will have to look to stronger partnerships with other donors and civil society groups to deliver its scaled-up program effectively. In some areas, Australia will be expected to take the lead. In others, it can draw on the capacity of others, while still maintaining the Australian brand. More generally, closer ties should be encouraged between political, religious and business leaders from the two countries. Such people-to-people activities help build mutual understanding, while providing valuable opportunities for learning and capacity building in Indonesia.

81. In many respects, the Indonesian aid program is now unique. It is different from how Australia has operated in Indonesia in the past, and how Australia is operating now in other countries in the Asia-Pacific region. But it may also point the way in some key aspects, which will be relevant for the medium-term direction of Australian aid – in particular, the importance of building institutional and human capacity, the renewed focus on broad-based economic growth, ongoing efforts to integrate program management, and more proactive use of partnerships.

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Glossary

ABS	Australian Bureau of Statistics
ADB	Asian Development Bank
ADS	Australian Development Scholarships
AFP	Australian Federal Police
AIDCP	Australia-Indonesia Development Cooperation Program
AIPRD	Australia-Indonesia Partnership for Reconstruction and Development
ANTARA	Australia Nusa Tenggara Assistance for Regional Autonomy
APC	Australian Productivity Commission
ATO	Australian Taxation Office
BRR	Rehabilitation and Reconstruction Agency
CDI	Centre for Democratic Institutions
CGI	Consultative Group for Indonesia
DAC	Development Assistance Committee
DFID	Department for International Development
DIFF	Development Import Finance Facility
DPD	Regional Representation Council
DSF	Decentralisation Support Facility
GOI	Government of Indonesia
IIDEA	International Institute for Democracy and Electoral Assistance
IMF	International Monetary Fund
JBIC	Japan Bank for International Cooperation
JCLEC	Jakarta Centre for Law Enforcement Cooperation
JICA	Japan International Cooperation Agency
KKPPI	Coordinating Committee on Policies for Accelerating Infrastructure Development
LAPIS	Learning Assistance Program for Islamic Schools
LDF	Legal Development Facility
MDG	Millennium Development Goals
NTB	West Nusa Tenggara
NTT	East Nusa Tenggara
ODA	Official Development Assistance

PENSA	Program for Eastern Indonesia SME Assistance
PNG	Papua New Guinea
PRS	Poverty Reduction Strategy
SMERU	Social Monitoring and Early Response Unit
STP	Specialised Training Program
TAMF	Technical Assistance Management Facility
UNDP	United Nations Development Program
UNICEF	United Nation's Chidrens Fund
WGLC	Working Group on Legal Cooperation

Annex I: Recent trends in poverty and social indicators

Indicator	Units	1996	1999	2002	2003
Population	million	193.8	202.8	212.0	215.3
– urban	% of total	37.1	39.4	44.4	42.1
Unemployment rate	% of labor force	4.9	6.4	9.1	9.5
Poverty line					
– national	% of population	15.7	27.1	16.0	15.1
– international (US\$1/day)	% of population	7.8	12.0	7.2	5.7
– international (US\$2/day)	% of population	50.5	65.1	53.5	48.8
Net enrollment ratio					
– elementary school	% of age group	94.8	92.7	92.6	92.6
– junior high school	% of age group	48.6	59.2	60.9	63.5
– senior high school	% of age group		38.5	39.7	40.6
Adult literacy rate	%	85.3	88.4	90.7	89.8
Life expectancy rate	%	63.9	65.5	66.2	66.2
Fertility rate	births per woman	2.8	2.6	2.3	2.3
Maternal mortality rate	per 100,000 births	373	307	307	
Household access to:					
– piped water	%	16.7	18.6	19.7	18.9
– own septic tank	%	26.1	30.4	33.5	34.0
– electricity	%	72.2	83.7	87.6	87.9

Source: World Bank, *Indonesia: New Directions* (January 2005) and *East Asia Update* (April 2005).

Annex II: Regional comparisons: Economic performance, business climate and governance

Indicator	Units	Source	Indonesia	India	China	Philippines	Thailand	Malaysia	Vietnam	Cambodia	Laos
Population	million	(1)	215	1,064	1,288	82	62	25	81	13	6
Income per capita	US\$	(1)	810	540	1,100	1,080	2,190	3,880	480	300	340
GDP growth rate	%	(1), (2)	5	9	9	5	7	5	7	5	5
Investment rate	% of GDP	(1), (2)	19	24	44	19	25	21	35	22	20
Inflation, GDP deflator	%	(1), (2)	7	3	2	4	2	4	5	2	17
Exports, goods and services	% of GDP	(1)	31	14	34	48	66	114	60	62	25
Foreign direct investment	US\$million	(1)	-597	4,269	53,505	319	1,949	2,473	1,450	87	19
Aid per capita	US\$	(1)	8	1	1	9	-16	4	22	38	53
Business climate:											
Time to start a business	days	(3)	151	89	41	50	33	30	56	94	198
Employment rigidity	index (100)	(3)	57	48	30	41	42	3	55	48	50
Cost of contract enforcement	% of debt	(3)	127	43	26	51	13	20	30	121	30
Growth competitiveness	rank	(4)	69	55	46	76	34	31	77		
Governance:											
Voice and accountability	% rank	(5)	36	54	7	48	52	37	7	25	7
Political stability	% rank	(5)	9	24	47	15	42	59	52	31	25
Government effectiveness	% rank	(5)	41	56	60	46	65	81	44	19	14
Regulatory effectiveness	% rank	(5)	37	27	35	50	51	65	28	44	10
Rule of law	% rank	(5)	21	51	41	32	52	65	36	17	8
Control of corruption	% rank	(5)	18	47	40	37	49	65	27	13	7
Corruption perceptions	rank	(6)	133	90	71	102	64	39	102		

(latest data available)

Sources:

- 1 World Bank, *World Development Indicators 2005*.
- 2 World Bank, *East Asia Update*, April 2005.
- 3 World Bank, *Doing Business in 2005*.
- 4 World Economic Forum, *Global Competitiveness Report*, 2004 (104 countries, 1 = best).
- 5 Kaufman, Kray and Mastruzzi, *Governance Matters IV: New Data, New Challenges*, May 2005 (100 = best).
- 6 Transparency International, *Corruption Perceptions Index 2004* (146 countries, 1 = best).

Annex III: Australian aid to Indonesia

(A\$million)

	2001–02	2002–03	2003–04	Expected outcome 2004–05	Budget estimate 2005–06
AIDCP	97.3	104.1	125.2	125.0	125.0
Other departments *	25.5	27.8	33.3	134.5	44.6
AIPRD				10.8	132.1
Total	122.8	131.9	158.5	270.3	301.7
Of which:					
Education	57.0	59.0	62.8		
Health	10.0	20.2	28.0		
Governance	23.8	16.2	35.5		
Other	32.0	36.5	32.2		
Memo:					
Total Australian aid	1,755.1	1,830.8	1,973.1	2,252.9	2,490.8
% to Indonesia	7.0	7.2	8.0	12.0	12.1

* Includes Tsunami relief in 2004–05. Source: AusAID.

Annex IV: Brief overview: Engagement of major donors in Indonesia

THE WORLD BANK

The World Bank has maintained an active presence in Indonesia since 1967 to support broad-based economic development with an emphasis on poverty reduction. It has financed programs in all sectors of economy, totaling US\$23 billion.

The two objectives of the World Bank Country Assistance Strategy for Indonesia 2004–07 are to:

- i Improve the **investment climate** for poverty reduction, focusing in five areas:
 - i *Maintaining macroeconomic stability.*
With the IMF, supporting reform of the Ministry of Finance, including public financial management and tax and customs administration.
 - ii *Building a stronger and diversified financial sector with more equitable access,* involving a new, medium-term focus on overall financial sector reform, including non-bank financial institutions, capital markets, rural and micro-finance, and improving the access of the poor to financial services.
 - iii *Fostering a competitive private sector* by integrating the private sector into its projects and implementing activities aimed at developing the private sector in a decentralised environment (for example, The Program for Eastern Indonesia SME Assistance [PENSA]).
 - iv *Building Indonesia's infrastructure* by addressing the challenges caused by inadequate infrastructure (competitiveness, power supply, water and sewerage, transport, and communications) through analytical and advisory services and financing.
 - v *Creating income opportunities for poorer households and farmers.* Programs such as The Land Management Program (FY05) and Community Driven Development programs (targeting participatory decision making and access to resources, examining opportunities

and risks for growth and investment, providing access to micro-finance, and raising on- and off- farm incomes) aim to reduce the vulnerability of poorer and rural households.

- 2 Make **service delivery** responsive to the needs of the poor by assisting Indonesia to establish mechanisms for improved accountability on the part of service providers including schools, health services, agricultural research centres and water companies. To accelerate the attainment of key Millennium Development Goals (MDGs) in education and health, the program focuses on:
 - > *Improving education outcomes for the poor* by addressing the issues of quality and school completion rates in basic education.
 - > *Improving health outcomes for the poor* by:
 - building capacity within the new decentralised system particularly in maternal health, child health and nutrition
 - raising the capacity of district health administrations through the Health Workforce and Services Project (2003–2008, US\$534 million)
 - making service planning and delivery procedures participatory and accountable through Provincial Health Projects (2000–2006 US\$117 million; 2001–2007 US\$999.6 million)
 - elevating the policy dialogue on HIV/AIDS
 - incorporating health activities into programs in other sectors, such as the Water Supply and Sanitation for Low Income Communities Project (2000–09; US\$184.1 million).

The World Bank also aims to foster transparency and accountability by:

- > *Increasing demand for good governance* through greater public participation in policy making and policy-monitoring processes across different levels of government.

- > *Strengthening the institutions* that are accountable for implementing laws to improve governance already passed during the *Reformasi* period.

An innovative feature of the most recent Country Strategy is its identification of four platforms as the focus of aid delivery: community driven development; local services; public utilities and at the national level.

Total expected World Bank loans to Indonesia over the period of the strategy (2004–07) is:

- > IDA: US\$920 million (base case);
US\$1.325 billion (high case)
- > IBRD: US\$2.105 billion (base case);
US\$2.95 billion (high case).⁵²

ASIAN DEVELOPMENT BANK

Indonesia was one of the ADB's 31 founding members. The *Indonesia Country Strategy and Program 2005* specifies four areas for support:

- 1 Continued support for **decentralisation**, primarily through the Local Government Finance and Governance Reform Program (US\$190 million). In addition non-loan support has been provided through Decentralised Pro-Poor Budgeting for Poverty Reduction (US\$1.8 million) and Decentralised Natural Resource Management (US\$600,000).
- 2 Supporting **social development** through loans for Sustainable Aquaculture for Poverty Reduction (US\$75 million) and Rural Microfinance (US\$30 million) and non-loan support, for example, Metropolitan Sanitation Management and Health (US\$1.2 million).
- 3 Promoting **long-term economic growth** through the State Owned Enterprise Governance and Privatisation Project (US\$400 million) and private sector support (US\$200 million).
- 4 Furthering **regional cooperation** through the Inter-Island Transport (Port) Subregional Project (US\$50 million) and non-loan support, for example Integrated Regional Development for Urban Services (US\$1 million).

The ADB provided assistance in Aceh and North Sumatra following the Tsunami, in the form of damage assessment and initial rehabilitation support.

Ten new loans (totalling US\$519 million) are proposed for 2005 targeting road rehabilitation, community water services, aquaculture development, local government financing and governance, microfinance, and private sector financing of urban infrastructure.

JAPAN INTERNATIONAL COOPERATION AGENCY (JICA) AND THE JAPAN BANK FOR INTERNATIONAL COOPERATION (JBIC)

Japan's assistance program in Indonesia is one of the oldest and largest of its bilateral programs. ODA is delivered to Indonesia in the form of technical assistance grants through JICA and concessional loans through JBIC.

The JICA program aims to address:

- 1 The medium-term challenge of **macroeconomic stability and sustainable growth led by the private sector**. Related activities aim to:
 - > *Establish fiscal sustainability* through provision of technical training and assistance in the field of banking and fiscal management and macroeconomics to Bank Indonesia, the Ministry of Finance and BAPPENAS.
 - > *Reform the financial sector*.
 - > *Improve economic infrastructure*.
 - > *Foster supporting industries and small and medium-sized enterprises (SMEs)* by providing support services and technical assistance.
 - > *Provide technical assistance for economy-related legal systems* in conjunction with the Supreme Court and the Ministry of Justice and Human Rights.
- 2 The long-term challenge of **realising a fair and democratic society** by:
 - > *Reducing poverty* through agriculture and fisheries development, fostering collaboration between community organisations and the

52 Source: World Bank, Indonesia Country Assistance Strategy FY 04–07.

government, and improving the standard of education.

- > Promoting *governance reform* through capacity building in local governments and promoting greater participation of stakeholders in local governance.
- > Supporting *environmental protection through collaboration with* the Environmental Management Centre and relevant ministries.

JBIC loans to Indonesia in 2004 addressed four policy themes:

- 1 Improved investment climate by development of **economic infrastructure** through:
 - > Keramasam Power Plant Extension Project (US\$87 million)
 - > Tanjung Priok Access Road Construction Project (US\$234 million).
- 2 Development of **disaster-resistant infrastructure**, including:
 - > Lower Solo River Improvement Project II (US\$83 million)
 - > Urgent Disaster Reduction Project for Mt. Merapi, Progo River Basin and Mt. Bawakaraeng (US\$146.3 million).
- 3 **Poverty reduction** through:
 - > Komerang Irrigation Project II-2 (US\$122.8 million)
 - > Development of the Faculty of Medicine and Health Sciences of Syarif Hidayatullah State Islamic University (US\$26.6 million).
- 4 **Global environmental issues** through:
 - > Ulebelu Geothermal Power Plant Project (US\$180.6 million)
 - > Engineering Services for Asahan No. 3 Hydroelectric Power Plant Construction Project (US\$7.7 million).⁵³

Japan's total ODA to Indonesia (FY2002–2003) is US\$891 million.⁵⁴

USAID

USAID's program to Indonesia is its largest in East Asia. The objectives of the *Strategic Plan 2005–2010* are:

- 1 To improve **decentralised basic education**. The Managing Basic Education Program is the cornerstone of the US\$157 million Indonesia Education Initiative. It aims to improve local government capacity to manage basic education services, as well as the quality of teaching.
- 2 To improve **basic human services**. The Basic Human Services Program (estimated to cost US\$37.1 million in its first year, 2005)⁵⁵ aims to improve local government services targeting:
 - > health and hygiene of vulnerable women and children
 - > nutrition
 - > increased access to clean water
 - > family planning/reproductive health
 - > health systems
 - > infectious diseases
 - > HIV/AIDS among at-risk populations
 - > surveillance capabilities for malaria, tuberculosis and polio.
- 3 To strengthen **economic governance**. The Promoting Economic Growth Program aims to strengthen government economic institutions in partnership with the private sector and civil society, and promote a demand driven policy environment. It is estimated that this program will cost US\$13.8 million in 2005.
- 4 To provide assistance for **effective democratic and decentralised governance**. The Democratic and Decentralised Governance Program (estimated at costing US\$35 million in its first year, 2005) aims to expand participatory and accountable local governance, support the reform agenda and address the roots of conflict while encouraging pluralism.
- 5 To strengthen Indonesia's role in the global coalition against **terrorism** by:

⁵³ Source: <http://www.jbic.go.jp/autocontents/english/news/2005/000019/>.

⁵⁴ Source: www.oecd.org/dataoecd/63/6/1877921.gif and <http://www.jica.or.id/strategy-new.html>.

⁵⁵ This money is drawn from the Exchange Stabilisation Fund (ESF). The ESF consists of three types of assets: US dollars, foreign currency and Special Drawing Rights. The ESF can be used to provide financing to foreign governments (<http://www.treas.gov/offices/international-affairs/esf/>).

- > creating a supportive environment for investment and trade, and thereby reducing poverty
- > supporting the transition from authoritarianism to democracy;
- > promoting human rights
- > addressing trans-border issues including HIV/AIDS and people trafficking
- > providing humanitarian relief services.

USAID's total assistance to Indonesia (2003) is approximately US\$160 million.^{56 57}

DEPARTMENT FOR INTERNATIONAL DEVELOPMENT

DFID's program to Indonesia was restructured in 2004 with two priorities:

1 Harmonisation in:

- > *Decentralisation efforts, including The Decentralised Quality Service Learning Project*

(GBP 330,000); and Support to Government Reform (GBP 4.7 million).

- > *Local service provision*, including the establishment of the DSF to coordinate new and existing DFID activities. This facility is estimated to cost GBP 5 million.

2 Addressing MDGs related to maternal mortality, TB and HIV/AIDS through international organisations and other donors. Activities include The Health Sector Preparation Fund (GBP 200,000) and The HIV and AIDs Program (GBP 30 million).

In response to the Tsunami, DFID provided support for humanitarian relief, recovery and reconstruction through international organisations and NGOs and through joint funding mechanisms with other donors.

The UK's total ODA to Indonesia (2002) is US\$38.8 million.⁵⁸

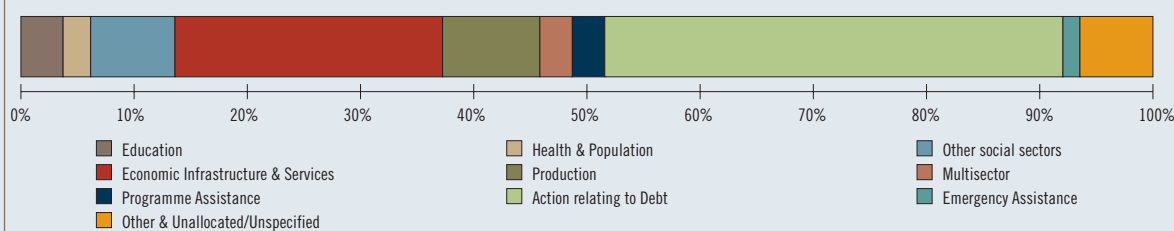
Summary of ODA to Indonesia

Indonesia

Receipts	2001	2002	2003
New ODA (USD million)	1 471	1 308	1 743
Bilateral share (gross ODA)	91%	88%	90%
Net ODA / GNI	1.1%	0.8%	0.9%
Net Private flows (USD million)	-947	-7	982
For reference	2001	2002	2003
Population (million)	209.0	211.7	214.5
GNI per capita (Atlas USD)	680	710	810

Top Ten Donors of gross ODA (2002–03 average)		(USD m)
1	Japan	891
2	United States	219
3	Germany	120
4	France	110
5	Netherlands	106
6	IDA	89
7	Australia	79
8	AsDF	37
9	EC	26
10	Korea	22

Bilateral ODA by Sector (2002–03)



56 USAID's total proposed assistance to Indonesia (2005–2010) is US\$650–700 million (USAID, Indonesia: Strengthening a Moderate, Stable and Productive Indonesia, draft report).

57 Source: http://www.usaid.gov/policy/budget/cbj2005/ane/pdf/id_programsummary.pdf and http://www.usaid.gov/id/documents/USAID_fact_sheets/EDU_E_031605.pdf.

58 Source: DFID Departmental Report 2005 and OECD, Geographical Distribution of Financial Flows to Aid Recipients 1998–2002.

Annex V: Terms of reference for Indonesia Country Report

To inform the development of a White Paper on a medium-term strategic outlook for Australia's aid program, a paper analysing the key development challenges for Indonesia was commissioned.

With the objective and geographic focus of the aid program reaffirmed in *Australian Aid: An Integrated Approach*, the key question confronting the White Paper is: Within the broader Australian Government engagement, how should the strategic direction of the aid program evolve from the current framework over the coming years?

In answering this question the Indonesia analysis should:

- > reflect an understanding of the development prospects and challenges facing Indonesia over the next five to ten years
- > build on the platform already established by the Indonesia aid program including lessons learnt
- > develop a clear understanding of where the Australian aid program can make a discernable difference in Indonesia
- > identify lessons and insights of broader interest and applicability to the aid program.

GENERAL QUESTIONS TO BE CONSIDERED IN THE INDONESIAN ANALYSIS

Development challenges

- > What are the trends over the next five to ten years that will impact, both positively and negatively, on growth, stability and poverty reduction in Indonesia?

Implications and directions for Australia's aid program to Indonesia

- > Where can Australian aid add value over the medium term in Indonesia, particularly with reference to:

- **Accelerating and sustaining growth** – focusing on the drivers for growth including property rights and surety of returns, regulatory constraints to private sector development, and market access?
 - **Boosting rural productivity** – particularly agriculture and role of research, small- to medium-scale enterprise development, building markets and economic and social infrastructure?
 - **Strengthening governance** – evolving to focus on matching national aspirations and structures with sound functioning institutions, leadership and decision making and with consideration given to affordability issues?
 - **Combating corruption** – building on both the supply of anti-corruption institutions and processes with the generation of demand?
 - **Building human capacity** – particularly human resource development, focusing on education, health and demographic change and impacts on employment?
 - **Addressing pandemics** – most pressingly HIV/AIDS and promoting regional leadership, but also emerging pandemics such as SARS, Avian Bird Flu and underlying health and surveillance capacity?
 - **Promoting environmental sustainability** – as it supports continuing growth particularly natural resource management and trans-boundary issues such as water?
 - **Enhancing stability** – through building state legitimacy, peace-building and conflict and disaster prevention, responses and transitioning to development, and helping to manage terrorist and criminal threats?
- > Where should the aid program be investing more and what should it not do in Indonesia?

Implementation

- > How should Australia's aid instruments, approaches and partnerships evolve to deliver effectively on its medium term strategic outlook in Indonesia?
 - What lessons have been learnt about what works and how these can be scaled up, including:
 - issues of ownership and affordability?
 - harmonisation and alignment with national development efforts and other donors?
 - sub-national approaches for specific challenges?
 - Are existing aid delivery mechanisms adequate for the medium term challenges and should Australia be adopting more programmatic approaches and, if so, where and how?
 - Who will be the program's key strategic partners over the medium term and how should the nature of these partnerships evolve?
 - How can institutional, academic, people to people and community links with Indonesia facilitate and enhance the aid program?

The Indonesian analysis should also consider:

- > The longer-term geographic focus of Australia's expanded assistance, as between areas of greater relative poverty and vulnerability (for example, in Eastern Indonesia) and other areas elsewhere where absolute poverty levels are higher.
- > Areas where Australia can help to play a leadership role as it is already doing in basic education and other niche areas of economic and financial management – options may include HIV/AIDS.
- > Areas where the development of long-term linkages between Australian institutions and Indonesian counterparts may support Indonesia's democratic transition and its management of key economic and legal reform processes.



8

Pacific Island Countries

Analytical report for the White Paper on
Australia's aid program

Prepared by
Professor Ron Duncan and James Gilling

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Executive summary

Australia has important humanitarian and strategic interests in the Pacific region. These are best protected by a prosperous region in which governments discharge their domestic and international obligations. These obligations include providing an environment conducive to investment (domestic and international), ensuring sound governance (including protection of property rights and the accountable collection and expenditure of revenues) and ensuring that prosperity is shared (particularly through providing equitable access to basic services).

The Pacific region's performance over the past decade has been weak. Social indicators suggest there is regression in health and poverty outcomes, that youth unemployment is rocketing and that the rapid urbanisation taking place has many unhealthy outcomes. Basically, the region is not on track to meet the Millennium Development Goals (MDGs). The root cause is a failure of the Pacific Island Countries (PICs) to grow at a rate that will lead to sustained increases in living standards for all. Substantial aid flows have mitigated the impact of this weak performance, but it appears they have done so at a cost.

PICs face a wide range of factors that make achieving robust and stable growth an uphill struggle. Their small size and remoteness mean that over the long term they must rely on niche market opportunities, rather than preferential market access for uneconomic activities. They are mostly newly

independent countries still coming to terms with the notion that a scattered collection of tiny islands can constitute a discrete state. They are vulnerable to climatic and trade shocks. In a rapidly globalising world, they have major disadvantages. Yet for most PICs, these obstacles are surmountable, as other nation states facing similar challenges have demonstrated.

The key problem for PICs is they have not taken control of the factors that will determine their fate. Their political governance is weak. Policies are not credible. Political systems have in-built instability. Public sectors are mostly too large and inefficient, often due to support from aid inflows. There is minimal accountability and high levels of corruption. Economic governance is also fragile, with few of the institutions that are essential for creating robust social and public capital to support market-based activities. There are high barriers to trade and investment, high levels of monopoly practice, and a preponderance of inefficient state-owned enterprises dominating some of the most important markets in the region, including telecommunications and power. Poor and obfuscatory regulations, underdeveloped financial markets (particularly in relation to land) and ineffective infrastructure complete a sorry picture for potential investors.

If PICs are to reach the growth rates necessary to achieve shared prosperity and stability, significant changes are required. Sound, locally owned policies need to be developed, backed by strong, locally-

designed institutions to support market-based activity. Most importantly, greater openness to external and internal trade, investment, and labour mobility is needed. However, PICs need to receive similar treatment from their trading partners.

Donors have a vital role to play. They have the technical knowledge to support important reforms, and the financial capital to provide transition costs in areas such as basic services. Yet their record in the region, by their own admission, is unsatisfactory. Newly announced donor strategies rightly acknowledge the need to change, and recent announcements in the area of supporting private sector development suggest progress will be made. But there is no room for complacency. There are strong indications that significantly more aid will be spent in the region over the next decade, including by new donors such as China and Taiwan. This could make a crowded field even more congested, further diluting domestic pressures for change.

For Australia, perhaps the most important donor to the region, this requires changes on several fronts. Programs in the region must be more clearly focused and targeted on achieving high levels of growth and removing the constraints—including weak political governance—preventing poor people from benefiting. It means increased investment in human capital, particularly in education. It may also mean taking a lead role in public sector reform, reflecting Australia's own experience in this area.

Process must also change, including better alignment of program activities with national policies. Australia needs to work harder to become a genuine partner to the region. Heavy dependence on Australian technical assistance as the primary delivery option needs to be reconsidered. A much tighter focus on performance management and research is needed, because too little is known about what changes must be made and how to make them. Investing in better, independent statistics on development outcomes is required. More effort is needed on the process of donor coordination, both through strengthening domestic aid coordination capacities and through high-level relationships with new and traditional donors, such as Japan and China, whose presence in the region could frustrate attempts to encourage change. More structure will also have to be brought to the support of regional approaches. Finally, building on the early work in Pacific 2020, more resources must be dedicated to research on the region.

1 Why is the Pacific Islands region important for Australia?

This section looks at Australia's motivation for being engaged in the Pacific Islands region. It notes that because of strong historical and cultural links Australians care about the welfare of the islands. Such concern is demonstrated during appeals for assistance in the face of natural disasters. New pressures on the region, including from globalisation and, potentially, climate change, strengthen this concern. The section also notes that, in the wake of increased apprehension about international crime, terrorism and global pandemics, the region's stability is inextricably tied to that of Australia.

HISTORIC AND CULTURAL LINKS

In its 2003 White Paper, the Department of Foreign Affairs and Trade (2003) notes that:

History has tied Australia intimately to the nations and peoples of the South Pacific. Australia helped to shape some of the island states as they became independent—their economic bases, power-sharing arrangements between the centre and the provinces, and philosophy of governance. And in some cases we passed on our institutions and the ideas underpinning them—constitutions, parliaments, public services, legal systems, and security forces.

Strong sporting links, and a substantial diaspora from the islands living in Australia, further consolidate this relationship. Moreover, hundreds

of thousands of Australians holiday in the region. Together, these forces create a strong public concern for the peoples of the Pacific.

SHARED PROSPERITY

These historical and cultural links also underpin a humanitarian concern. Strong support for disaster appeals is one manifestation. So is the Australian Government's substantial aid program (A\$463 million). This humanitarian concern will probably grow as the extent of poverty—now thought to be around 20 per cent of the population—is more widely realised. Concern about the potential negative consequences of globalisation and climate change will likely strengthen the humanitarian dimension of the relationship.

CREDIBILITY

As other powers have withdrawn from the Pacific, Australia is increasingly expected by the international community to take a lead role in maintaining stability. The aid program makes no bones about this. The current Minister for Foreign Affairs states in the introduction to AusAID's regional aid strategy (2004) that there is '...a strengthened realisation that a porous and under-developed region is neither in the Pacific's or Australia's interest'. It follows that the performance of the region reflects upon Australia's implicit responsibility.

COMMERCIAL

Despite being a main exporter to the region, Australia's commercial reliance on the region is not substantial. Merchandise exports in 2004 were worth A\$624 million, and imports were valued at A\$319 million (ABS, 2005). These represent around 0.5 per cent of Australia's total exports and 0.25 per cent of its total imports. Services trade is insignificant, except to Fiji, which takes services exports of A\$129 million and provides services worth A\$417 million in return.

STABILITY

The stability of the Pacific region has always featured highly in Australian foreign policy. Prior to current concerns about terrorism, the region was a focus of cold-war politics. International concern about boat people, money laundering and drug running also influenced Australian policy. Today, international concern about regional stability focuses on a growing appreciation of the risks presented by what have become known as 'fragile states' (Box 1). These risks can impact negatively on the livelihoods of the populations of the fragile

states themselves, and on neighbouring countries, including Australia. Such risks include: threats from criminal gangs using weak states as entrepôts for entry to Australia, for example for smuggling narcotics and arms; trans-boundary implications from the failure to manage effectively the spread of diseases such as SARS and Avian Flu; and, more speculatively, the threats posed by hostile powers establishing a foothold in the region.

OUTLINE OF THE REPORT

This report is in six sections. Following this introduction, section two summarises the recent economic performance of the region. Section three explains what lies behind this performance. Section four considers the prospects for the region over the next decade, and posits what would be needed to attain strong, sustained five to seven per cent growth—the level required to raise living standards substantially. Section five asks how donors as a group can support such an ambitious growth target. Finally, section six considers Australia-specific opportunities to support this growth target.

BOX 1: VIEWS ON THE FRAGILITY OF THE PICs

The recognition that there is a group of states that has proved largely unresponsive to donor-led reforms has inspired a growing body of research into how the outcomes can be improved. The range of definitions of unresponsiveness is large and complex. Nonetheless, the core definition is that the countries concerned have governments unable or unwilling to use resources to encourage growth and reduce poverty. Changing this is important for humanitarian reasons, to enable Pacific peoples to participate fully in economic activities and thereby lift their living standards considerably, and for reasons of political and economic stability.

Early in the evolution of research into state fragility, the countries initially highlighted included Afghanistan, the Sudan and Liberia. As awareness grew of the underlying issues that contributed to fragility, the list of countries grew. It now includes more than one-third of the PICs. In addition to Solomon Islands, which features on most lists, Tonga, Kiribati and Vanuatu have been identified by the World Bank as at risk, through appearing in the lowest two quintiles of their Country Political and Institutional Assessment rankings. Fiji is identified by Robert Rotberg, author of *Why States Fail*, as a weak state, because of its perceived inter-communal antagonisms. The non-appearance of Nauru in these definitions probably results from a lack of data rather than a perception that it is not at risk.

2 Recent economic performance in the Pacific Island Countries

The thrust of this section is that:

- > with few exceptions, per capita growth in the PICs has been negligible, even negative
- > governments are getting into more debt, without much to show for it in terms of more productive economies
- > social indicators suggest serious slippage, notably in the areas of poverty incidence and health standards
- > there are significant disparities between rich and poor and between urban and rural areas (including outer islands) with respect to service delivery
- > youth unemployment is high in many countries and likely to worsen
- > rapid rural-urban migration, combined with poor job creation, is leading to significant problems in local government
- > there are signs of increasing social problems in several countries related mainly to high youth unemployment, including youth suicide, crime, and disintegration of traditional support systems.

The economic performance of the PICs between the second half of the 1990s and the first half of the 2000s varied considerably from country to country (Table 1). Cook Islands, Fiji, Kiribati, Samoa, Tonga, and Tuvalu all had positive per capita GDP growth during this period, while Marshall Islands, the Federated States of Micronesia (FSM), Solomon Islands, and Vanuatu experienced negative per

capita GDP growth, on average. Global cross-country research has shown that per capita income growth rates have to be above two per cent for poverty to be reduced (Dollar and Kraay 2001). If this result holds in the PICs, only Cook Islands (6.5 per cent) and Samoa (3.1 per cent) would have made inroads into poverty reduction over the past decade. In countries with per capita GDP growth below two per cent (Fiji and Tonga) and countries with negative per capita GDP growth rates (Marshall Islands, Solomon Islands and Vanuatu), poverty is likely to have worsened. The civil unrest in Solomon Islands and the coup in Fiji can be blamed for a substantial part of the poor economic performance of these countries. While aggregate income in several countries has been stagnant, inequality has risen. The Gini coefficient for Marshall Islands, for example, is amongst the highest in the world. The basic arithmetic of this implies that those at the bottom of the income ladder must have seen a sharp decline in their income.

How have the PICs done by comparison with other developing countries? Comparisons are in Table 1. The average 1995–2003 per capita GDP growth rates of the Low Income, Lower Middle Income, and Low and Middle Income countries are all higher than that of the PICs (0.7 per cent average for 1995–2004), which suggests PICs are not doing as well as many other developing countries. The small economies of the Caribbean are widely used as comparators for PICs. For the 12 Caribbean countries for which

World Bank per capita GDP data are available, the average per capita GDP growth rate for the period 1970–2003 (not all countries have data covering the full period) was 2.8 per cent. For the ten PICs for which these data are available, the average per capita GDP growth rate was one per cent. For the period 1995–2003, the average for the Caribbean countries was 1.6 per cent, compared to the 0.7 per cent average for PICs for 1995–2004.

The economic performance of Cook Islands improved substantially following the comprehensive economic reform program begun in 1996, moving from a negative GDP growth rate in 1995 to a positive 5.8 per cent in 1998 and 13.9 per cent in 2000. Its performance since then has been less impressive, with GDP growth rates in the three to five per cent range. Cook Islands' population has declined at an annual rate of 3.4 per cent over the past ten-year period because of emigration, resulting in a very high rate of per capita GDP growth.

Samoa had two years of six to seven per cent GDP growth in 1995 and 1996 and another two years of growth at similar levels in 2000 and 2001. The economic reforms undertaken in the 1990s, such as tariff reductions, adoption of the Value Added Tax (VAT), liberalisation of the foreign investment environment, and public sector reform, appear to have played a role in the reasonably good performance over the past decade. Drought and the downturn in tuna harvests help explain the disappointing GDP growth of one to three per cent since 2001. However, there are signs of backsliding on reforms in the investment environment and in economic management.¹

While per capita GDP growth in Kiribati has been reasonable, the Kiribati economy is primarily services (75 per cent). Moreover, public administration is the major part of the services sector and the only component of the economy that has grown (doubling over the past decade in current dollar terms). Thus the Kiribati economy is largely driven by aid, fishing licence fees, trust fund revenues, and remittances, with most of these funds supporting growth in the public service.

The economy of the Solomon Islands suffered a considerable decline during 1999 to 2002 as the result of civil unrest. The economy is recovering following the regional intervention that stabilised the security situation. However, at recent rates of GDP growth, it will take 20 years just to recover to the output levels before the civil unrest. Improvements in performance across all sectors of the economy are needed to generate the rapid growth needed to improve living standards rapidly and reduce the likelihood of future domestic conflict. A particular challenge will be how to replace the revenue from unsustainable logging, which accounts for half of the current five per cent GDP growth.

Vanuatu has experienced considerable political instability in recent years and averaged only one per cent GDP growth during 1995 to 2004, which translates into an annual per capita GDP decline of 1.6 per cent over the past decade. Seventy-five per cent of the Vanuatu economy is recorded as services—a large part of which is public administration. As elsewhere, macro-economic stability has been achieved relatively easily in Vanuatu. In 1998, when the Comprehensive Reform Program was introduced, the fiscal deficit was 10 per cent. In 2004, the government budget recorded a surplus of 1.1 per cent. However, achieving micro-economic reform has proven difficult. Moreover, the level of the exchange rate favours the small urban sector while penalising the export prospects of the majority living in rural areas.

Only 15 per cent of the economic output of the Marshall Islands is contributed by agriculture and manufacturing. Of the remaining 85 per cent of GDP, the public service and state-owned enterprises form the bulk. Hence, the economy is basically funded by the aid funds distributed under the Compact of Free Association with the United States.

2.1 FISCAL DEFICITS AND DEBT

The budget deficits of most PICs widened in the late 1990s and early 2000s and increased budget deficits have led to increased public debt burdens. Propping up loss-making, state-owned enterprises is a major reason for the increased budget deficits, as

1 The International Finance Corporation's Starting a Business database says it takes on average 73 days to set up a business in Samoa, compared to the regional average of 51 days. The average time for Fiji is 45 days and Vanuatu 39 days.

Table 1: Key economic statistics of selected PICs and international comparators, 1995–2004

COUNTRY	GDP GROWTH 1995-2004 (%)	POPULATION GROWTH 1995-2004 (%)	INFLATION	EEZ ^A (KM ²) (THOUSANDS)	ESTIMATED POPULATION (THOUSANDS)	PER CAPITA GDP GROWTH 1995-2004 (%)
Cook Islands	3.1	-3.4	2.4	1,830	18.4	6.5
Fiji	2.6	1.0	4.2	1,135	819.0	1.6
Kiribati	4.1	1.8	2.6	3,550	87.4	2.3
Marshall Islands	-2.0	2.6	1.2	...	56.6	-4.6
FSM	-0.5	0.1	-0.3	...	107.5	-0.6
Nauru	...	2.4	...	431
Samoa	4.1	1.0	0.1	96	177.7	3.1
Solomon Islands	-0.8	2.7	12.5	1,116	490.0	-3.5
Tonga	2.2	0.5	11.6	596	101.0	1.7
Tuvalu	3.3	1.3	3.3	857	10.9	2.0
Vanuatu	1.0	2.6	3.0	857	202.2	-1.6
Caribbean countries	1.6					
Low Income Countries	3.2					
Lower Middle Income Countries	3.6					
Low and Middle Income Countries	2.3					

Notes: a : EEZ - Exclusive Economic Zone, ... Data not available.

The per capita GDP growth rates for the Caribbean, Low Income, Lower Middle Income, and Low and Middle Income countries are for the period 1995–2003.

Sources: ADB (2004) *Key Indicators 2004*; ADB (2005) *Asian Development Outlook 2005*; World Bank, Online Database.

is the inability of governments to generate revenue increases sufficient to match the needs of fast-growing populations. In some cases fiscal deficits have been financed by external borrowings. For example, Tonga's external debt/GDP ratio increased from 42 per cent in 1998–99 to 53.5 per cent in 2002–03. In other cases there has been 'public capture' of national provident funds. For example, in Fiji, fiscal deficits have been primarily financed by borrowings from the Fiji National Provident Fund (of the F\$2.5 billion of public debt in 2004, around 80 per cent was held by the fund). External debt in Fiji therefore remains at relatively low levels.

Fiji's net deficit stood at 0.6 per cent of GDP in 1999 but increased to 5.6 per cent of GDP in 2002. This increase resulted from the need to follow an expansionary fiscal policy to restore confidence and set the foundations for growth following the 2000 political crisis. Financing of the deficit led to a build up of debt, which stood at 37 per cent of GDP in

1999 but had increased to 47.7 per cent of GDP by 2002 and to 53.7 per cent in 2004.

External debt of Solomon Island increased almost four-fold during the period of civil unrest. Samoa's public debt rose significantly as the result of the losses made by Polynesian Airlines. However, in line with its other reforms of the public sector, Samoa reduced its debt/GDP ratio from 63 per cent in 1999–2000 to 47 per cent in 2003–04. Vanuatu's debt/GDP ratio has increased to 38 per cent as the result of the Vanuatu Provident Fund crisis and the financing of infrastructure.

2.2 POVERTY IN THE PACIFIC

Analysis by the Asian Development Bank (ADB) of poverty in South Pacific countries, carried out over 2000 to 2003, concluded it is a significant problem in the Pacific. There are no time-series data available

on poverty measures so it is not known how poverty has been affected by the poor economic growth of many PICs. Still, countries finding it difficult to maintain real per capita income levels, and which have increasing income inequality, are more likely than not experiencing increasing levels of poverty.

Poverty of a kind that means severe malnutrition and death, as seen in Africa and South Asia, is not present in the Pacific. However, poverty at a level that leads to difficulties in meeting basic needs in food, clothing and shelter, as well as severely limited access to education and health services, exists in urban and peri-urban areas, as well as in the more isolated and less fertile rural areas and in the outer islands. The ADB undertook substantial analysis of household income and expenditure surveys. While mostly dated, these showed significant levels of poverty below basic needs—ranging from 12 per cent of the population in Cook Islands to 40 per cent in Vanuatu and 50 per cent in Kiribati.

The ADB also undertook extensive surveys of the poor in eight of the Pacific states. These surveys revealed that the key concerns of poor people are insufficient job opportunities, unusable roads, deteriorating transport and other public services, and lack of safe drinking water. Not surprisingly, the poor want access to cash income-generating opportunities and to social services, especially primary education and health care. Pacific states with substantial proportions of their population living in dispersed, isolated communities present special challenges for development policy and development assistance.

The migration from Pacific countries to metropolitan countries can mean that costs of support for the poor are transferred to destination countries if migrants end up on welfare. For instance, a case could be made that New Zealand is contributing much more than is reflected in its aid budget in income support of Pacific Islanders.

2.3 SOCIAL INDICATORS

A substantial challenge in reporting against social indicators is the paucity and weakness of data. Weaknesses include the lack of time-series data, incompatibility between national-level data, and the

absence of intra-country information. Even where raw data has been collected, analytical resources are limited, so easy-to-use information is at a premium. A further concern is that, even when data exists, governments can be reluctant to release it when it suggests deterioration in standards.

In the face of these challenges, the South Pacific Community (SPC) and the United Nations Development Programme (UNDP) in late 2004 completed an analysis of the performance of the region against the MDGs. Whilst acknowledging the limitations in data quality and availability, the review revealed a mixed picture, with progress differing across the region. The report noted ‘substantial progress’ and indicated that the region was on track to meet some of the MDG targets. But it also recognised slow progress, particularly on health and poverty indicators. With health, the report warned of a reversal of gains.

MDGs for **gender** equality and the empowerment of women show the region still has progress to make to fully tap the economic potential of its women. Consistently, less than one-half of women are engaged in wage labour in the non-agricultural sector, with FSM and the Solomon Islands scoring particularly low. Only Fiji and Nauru have ten per cent or more of their seats in national parliament held by women. Solomon Islands, Tonga and Tuvalu have no women holding seats.

With respect to the **education** MDGs, FSM, Nauru, and Solomon Islands are some way from achieving universal primary enrolment. Also of concern are low levels of retention (grades 1 to 5) in Fiji, FSM and Samoa. New work by the World Bank has also thrown light on education outcomes. Studies undertaken in 2004 suggest that in English language tests for Year 4 students several countries had around 40 per cent of students at risk of failure, and even worse performance levels were reported at Year 6. The studies also suggest high levels of inequality in access to education services (the concerns expressed by the poor to the ADB). This is most pronounced at the secondary levels. In Vanuatu, for example, less than 20 per cent of children in the poorest fifth of the population attend secondary schools. Kiribati, Palau, FSM, Republic of the Marshall Islands (RMI), and

Samoa have less than 50 per cent of poor children attending secondary schools. The goal of equal educational opportunity will likely not be reached.

With the MDGs on **health**, only Vanuatu is convincingly on track to achieve the target for under-five mortality (it has reduced the rate from 79 per 1,000 live births in 1989 to 33 in 1999). Life expectancy has improved across the region, with an average of 62 in Kiribati and up to 71 in Tonga, although the increasing incidence of so-called lifestyle illnesses could soon lead to declining life expectancy in some countries, such as Nauru. Fertility rates are also declining (although at a slower rate amongst poorer women). The impact of wealth on access to clean water is also revealed by the World Bank study. In Kiribati, at one extreme, only 30 per cent of the lowest quintile has access to safe water, compared to almost 100 per cent of wealthy families. Samoa, by contrast, has almost equal rates of access, as does Palau. Inequality is even more marked with access to improved sanitation—only in Palau and Samoa do more than one-half of the poorest households have access to improved sanitation, while poor families in Kiribati have almost zero access.

The number of reported **HIV** infections in PICs is low, at 956 (as at March 2005), with 278 deaths from AIDS reported as of June 2004. But the trend is upward and the reported data are almost certainly underestimates. The high prevalence of sexually transmitted infections, gender-based violence and other related risk factors increase vulnerability for HIV transmission. In addition to the usual vulnerable groups such as commercial sex workers, men who have sex with men, and young people, vulnerable groups include seafarers and uniformed services personnel (especially those participating in overseas peacekeeping missions). Moreover, with high youth unemployment and increasing drug use, the risks for further increases in infection are high.

The conclusion that Pacific states simply need to increase funding for these social sectors is not valid. Indeed, the World Bank report states that ‘public spending on health and education are at par or above those for countries at the same level of development’ and states are devoting more than a quarter of their public funds to health and education spending (World Bank, 2004). On a per capita basis, countries spend

an average of US\$79 on health services, and all countries except Vanuatu and Tonga report higher spending than the average for East Asia and the Pacific (US\$48).

Much of this public funding is provided by donors. Fiji, FSM, RMI, Palau, Solomon Islands, Tonga, and Vanuatu spend more than half of their aid funds on social sectors. Simple analysis of the effectiveness of this aid suggests that donor funds do not have the significant impact on outcomes that might be expected (World Bank, 2004). This points to the detrimental impact the region’s poor governance and policy environment has on outcomes. Indeed, where governance is poor, the impact of public spending on basic educational outcomes is almost zero.

2.4 INCREASING URBANISATION/SQUATTER SETTLEMENTS

Rapid urban growth (up to five to six per cent per year) experienced in most PICs is the result of rural-urban migration. Reasons for this are not altogether clear but they do not appear to be related to positive factors such as rapid growth of employment in urban areas. The rapid urban-rural migration is more likely due to parents moving to urban areas seeking better education for their children because of the poor quality of education in rural areas, queuing for formal sector jobs, people being pushed out of communal areas because of low output productivity growth and high population growth, and young people seeking the bright lights of urban areas. With Fiji, the displacement of Indo-Fijian farmers after leases to sugar cane farms expired recently became a major contributor to the rural-urban migration and increased numbers of squatters.

In Polynesian and Micronesian countries, more than half the population will be living in the few urban areas within ten to 15 years. This migration is placing huge stress on local government resources, and especially on natural resources such as lagoons and freshwater lenses in the atoll island countries. The substantial growth of squatter settlements, particularly in Fiji, Marshall Islands, Solomon Islands, and Vanuatu, is posing major problems with access to land and supply of services. Local governments have to supply services such as garbage collection,

water and sanitation to squatter settlements, which is raising questions about how best to integrate the settlements into local government structures. Should they, for example, have to pay for services and have representation in government?

Urbanisation per se is not necessarily bad since urban areas exist because of the benefits derived from scale and agglomeration. The key issue is that urban development should be managed well so services are delivered effectively. The dispersed nature of many of the PICs with small, isolated communities means delivery of services is very high cost. There can be benefits, therefore, to moving people to urban centres. However, if the isolated communities continue in an even less viable state, with increasing costs of service delivery due to even smaller and more elderly populations, the net outcome of the rural-urban migration could be negative.

2.5 POPULATION DYNAMICS

Projected population growth rates for PICs vary widely between countries. Cook Islands is expected to continue losing population over the next 25 years at an annual rate of one to two per cent through migration to New Zealand. Fiji, Nauru, Samoa, Tonga, and Tuvalu, which also have relatively easy emigration access to metropolitan countries, are projected to experience population growth of 0.5 to one per cent; while the populations of French Polynesia and New Caledonia are projected to grow at around 1.5 per cent. The PICs expected to have the most rapid population growth over the next 25 years are FSM, Kiribati, RMI, Solomon Islands, and Vanuatu, with projected growth rates of two to 2.5 per cent. This last group will obviously have to sustain high GDP growth to achieve substantial, widespread increases in living standards. They are also some of the countries that have had the greatest difficulty in achieving positive per capita income growth over the past decade.

All PICs have relatively high fertility rates and therefore have large cohorts of young people. In countries experiencing strong investment growth, a large supply of youthful labour can provide a

demographic bonus, as experienced in East and South-East Asia. However, when investment is not growing strongly, the youth bulge can be a problem, including through contributing to political instability. Large numbers of young unemployed male youth in urban areas can be an ingredient for political instability by providing the manpower for those keen to foment civil unrest.

Through relatively easy emigration possibilities, young people from several PICs have for many years been able to find employment elsewhere; thus reducing the population growth and contributing substantially to the economy through remittances. In recent years, for various reasons—including the ageing of the populations in developed countries—the possibilities for short- to medium-term off shore employment and remittances have become more widely available to skilled and highly skilled labour in the PICs.² However, for the countries where populations are expected to grow most strongly, such opportunities are not so readily available. It will be in these countries that the problems of youth unemployment will be most worrisome.

While the employment of younger people overseas for substantial periods provides them with jobs not available at home because of the low levels of domestic investment, their absence can create problems. For example, the recent increase in the off shore movement of nurses and teachers has raised considerable concern about declines in the quality of medical and education services in PICs. The loss of younger people from isolated communities could also lead to a decline in traditional social security mechanisms.

In conclusion, it is clear governments are failing to meet the aspirations of their people. Unless governments can create conditions for much improved economic performance, aid and emigration opportunities are probably all that stand in the way of a more serious breakdown of state legitimacy and capacity in the region. However, there can be a serious moral hazard problem with aid in that aid itself can contribute to the incapacity of the state.

2 In Fiji, remittances earned by teachers, nurses, and military and security personnel have climbed rapidly in recent years. It is reported that close to 3,000 Fijians have been recruited into the British defence forces. Prior to 2001, net remittances were negative in Fiji. However, they amounted to 2.9 per cent of GDP in 2001 and 3.4 per cent of GDP in 2002, and are estimated at around F\$300 million in 2004 (approximately equal to the export revenues earned by sugar) and projected to be F\$500 million in 2005. While these overseas workers are primarily indigenous Fijians, the permanent migration of skilled and highly skilled Indo-Fijians continues unabated at around 5,000 per year.

3 What are the reasons for poor economic performance by the Pacific Island Countries?

This section identifies the reasons PICs are falling behind other developing countries. It argues that the fundamental problem is an inadequate environment for private sector growth. This inadequacy is attributed to three types of weakness: particularly for the micro states, such as Nauru and Tuvalu, the binding constraint is the high costs of doing business, both natural and imposed; for the larger states, besides the natural disadvantages of remoteness and smallness, the problems can be found in weak governance and an investment climate hostile to private investment, both domestic and foreign. Some conclusions drawn are:

- > the smallest, most isolated states may well face insurmountable obstacles to achieving sustainable growth and remain dependent upon aid
- > PICs have an inherent difficulty in achieving good governance because of their small populations
- > political instability and antipathy towards markets and private property rights makes economic liberalisation problematic
- > regulatory barriers to informal sector activity obstruct the development of entrepreneurship
- > problems giving rise to the PICs' poor economic performance and outcomes such as high youth

BOX 2: DO SMALL COUNTRIES GROW MORE SLOWLY?

Despite the seeming disadvantages of small countries, cross-country studies have not found a negative relationship between smallness and economic performance—whether economic performance is measured by income levels or economic growth rates (Milner and Westaway 1993, Armstrong *et al.*, 1998, and Easterly and Kraay 2001). Recent research undertaken for the Pacific Islands Forum Secretariat showed that from 1995 to 2003 PICs as a group grew more slowly than other groups of small island states, even allowing for the fact that three of them (Fiji, Papua New Guinea and Solomon Islands) suffered economically from civil unrest during this period (Sampson 2005). While their remoteness from major markets accounts in

part for their slower growth, their smallness *per se* does not. Further, the recent erosion of trade preferences resulting from the trade liberalisation agreed to under the WTO Uruguay Round did not contribute to their slower growth.

However, research by Winters (2005) shows that the costs of isolation and small domestic markets can be so large that it may well be uneconomic for some very small states to trade—that is, they are naturally autarchic. This situation has obvious implications for their potential growth rate. But it does not mean they should protect domestic industries—quite the opposite in fact (Chand 2004).

unemployment favour the development of illegal activities and regional insecurities

- > there is cause for some concern over the adverse impacts of aid on economic performance in PICs.

3.1 THE IMPORTANCE OF SIZE

Are small island countries such as PICs condemned to slower economic growth than others because of their size and remoteness? Most research undertaken to date suggests not. The research results reported in Box 2 indicate that small island countries can, on average, grow as fast as larger countries. However, the geographic isolation of PICs increases the difficulty of achieving economic growth, and the combination of smallness and remoteness of the micro-states—which are usually not well represented in empirical research because of data limitations—may mean growth opportunities are severely limited.

3.2 THE QUALITY OF GOVERNANCE

3.2.1 POLITICAL GOVERNANCE

There is widespread belief that governance problems lie at the heart of the difficulties PICs are experiencing in improving the welfare of their peoples. Research into governance is moving towards agreement that the quality of governance is the outcome of the appropriateness of political institutions and the incentives they provide for individual behaviour—and ultimately of government behaviour—or the extent to which the existing institutions are enforced.

Political science theories about the relationship between political institutions and governance quality point in two somewhat contradictory directions: (i) the risk of arbitrary behaviour associated with the concentration of power; and (ii) the virtue of flexibility and thus the ability to respond swiftly—a quality associated with more concentrated power sharing. The first direction leads to more decentralised political institutions. The second points to more concentration of power.

Thus, there appears to be a trade off between political credibility and flexibility in the structure of political institutions. Fragmentation of power has a positive

impact on governance quality as it creates checks and balances, and hence exerts some control over discretionary behaviour. However, beyond a point, the benefits of dispersing power may be offset by governance problems associated with fragmentation. Because promises made by governments are often not self-enforcing, division of power can help a government keep its commitments credible through accountability mechanisms designed to limit the abuse of executive power, and provide a system of punishment for undesirable government intervention and reward for desirable interventions. Regular auditing of public accounts and more vigilance by national media are some mechanisms believed to improve transparency and accountability. However, in a concentrated political power system, these means are often absent or highly ineffective.

The small Pacific economies generally do not appear to have the balance right between credibility and flexibility. They function like highly authoritarian political systems in that mechanisms for ensuring good governance such as auditing and media freedom do not appear to work well. Due to the smallness of the populations and the resulting close relationships between those holding positions of authority, the normal checks and balances between political institutions are not very effective (what Harberger 1988 has called the tyranny of demography). Further, PIC governments generally do not see Non Government Organisations (NGOs) as partners but more as antagonists. In part, this is due to the activist policies of the NGOs but there must also be an element of competition between governments and NGOs over aid funds.

There is substantial pressure from various quarters in the Pacific to involve traditional authority structures more in government in order to improve governance. However, getting the balance right with respect to such fragmentation will not be easy. One possibility may be to give traditional authority more power and resources to govern at the local village level and thus to benefit from the checks and balances that operate at the local level, while trying to find ways to introduce more effective checks and balances at the national level. Having traditional authorities play a larger role at the national level, as is done in Fiji and has been suggested in Vanuatu and other PICs, may not be

helpful. Traditional leaders have used the institutions of the introduced state to consolidate their own positions of power, sometimes at the expense of the traditional checks and balances in place to condition their behaviour. For example, chiefs in Fiji and the Marshall Islands have registered land in their own names and are collecting the bulk of rental income generated from the asset. Land rights, moreover, have been used to mobilise voters, thus allowing traditional chiefs to successfully contest national elections.

There is proliferation of political parties and lack of ideology/policy platforms in most PICs, often resulting in the formation of unstable coalition—and ultimately poorly-performing—governments. These outcomes may be related to the electoral and parliamentary systems adopted. Some electoral system engineering has taken place (in Fiji and New Caledonia) but the jury is still out on whether these changes have improved government performance. Constitutional and electoral system change is topical in the Pacific and warrants close attention for the possibilities that may arise to improve governance. There appears to be considerable room for research with respect to the lack of political parties/ideology; the relationships between parliamentary/electoral systems, political behaviour, and economic performance; the benefits and costs of incorporating traditional government into the adopted Western systems; and whether reform of political institutions would be beneficial.

In strictly constitutional terms, only two countries of the region (Solomon Islands and Fiji) have encountered unconstitutional government overthrow. But political instability, characterised by frequent change of government, is a hallmark of the region; for example, Nauru has seen 11 governments since 1996. Moreover, as Box 1 shows, several states in the region are now thought to present dimensions of fragility that are associated with instability.

To some degree, these states are going through the same kinds of constitutional debates that countries such as Australia and the United States went through years ago, with regions threatening to leave if they did not get their way. These disputes should be seen more in the way of the struggle towards the optimal contract between parties over the sharing of government and resources. However, it is important that there

is resistance to the breaking up of countries and the formation of more high-cost, small states. Aid donors should not subsidise smallness, which is frequently taking place in the Pacific with donors meeting the costs of tiny states undertaking all the trappings of statehood. Some of these state activities, such as ensuring phytosanitary and transport standards, are essential but the costs may well be rising, especially as international standards are rising. Other state-related activities such as postings to international organisations are less essential but also costly.

Political instability, civil unrest, the prospects of continuing poor economic performance, high population growth, and increasing youth unemployment are of concern since they could lead to the development of international criminal activity and regional insecurity. Regional security concerns relate to more than political actions. They include the weakening of quarantine and health barriers and increases in criminal activity. Recent research has shown the importance of the neighbourhood effect of civil unrest and poor governance (Chauvet and Collier, undated). The civil unrest in Bougainville, Fiji and Solomon Islands appeared to have flow-on effects to other countries in the region. The mismanagement of fishing and logging resources has encouraged the entry of corrupt elements and there is the possibility of such criminal elements developing close relationships with governments. Once entrenched in this way, these elements are difficult to remove. Criminal elements undertake all kinds of illegal practices, such as gun running, people smuggling, drug trade, prostitution, and money laundering.

A basic issue to be faced is that those in power are benefiting from existing institutional arrangements (such as constitutions, electoral systems, parliamentary systems, administrative systems, and law and justice systems) or by seeing that they are not enforced. They are not, therefore, keen to see the situation change. This is the core of the political governance problem. The basic questions about political governance therefore relate to ways of improving institutions or, if the institutions are appropriate, to enforcing the rules these institutions provide.

One possibility for introducing institutional change is to design reforms, or packages of reforms, that benefit

those holding political power as well as the public. Another possibility is to introduce ‘smart’ reforms that subtly create pressures for change in institutions or their enforcement. Withholding aid to try to force change is not a viable strategy for Australia as there are too many other potential donors willing to assist these small countries.

3.2.2 ECONOMIC GOVERNANCE

Following independence, the new governments in PICs took on many of the productive activities outside of agriculture, as well as utilities and major infrastructure such as ports. Manufacturing, largely in the nature of minimal processing activities, was widely supported through protection. With inevitable losses by public enterprises, because of their monopolistic and rent-seeking characteristics (over-manning, excessive salaries and inefficiency), as well as political interference, plus the indiscipline of public expenditure and corruption, fiscal deficits and growing public debts became widespread, with resulting fiscal crises. Also, increasing political instability, with governments formed of unstable coalitions, led to unstable policies and extreme difficulty in introducing micro-economic reforms.

The above factors contribute to the lack of investment, jobs and economic growth in PICs. However, behind these problems is a fundamental obstacle—the resistance to open markets from the vested interests that have developed. Many who have become well off have largely acquired their wealth due to governments creating monopoly positions through, for example, restricting trade and investment or from establishing privileged positions in parastatal organisations. Therefore, in the Pacific there are few ‘champions’ of open markets. Moreover, the belief in the pre-eminence of government appears to fit comfortably with some traditional communal systems under which Pacific peoples still live outside the urban areas.

The difficulties that development assistance agencies have in assisting PICs to liberalise their international trade and investment regimes, to privatise their state-owned enterprises, to create more favourable conditions for private investment, and to reduce the use of commodity price stabilisation schemes and agricultural and development banks stem from

antipathy towards open markets. The antipathy towards open markets also explains the lack of interest in establishing secure property rights and ensuring impartial enforcement of contracts—the foundations of effective markets and private sector development.

It appears critical to create vested interests in open markets. Therefore, it is important to keep promoting ideas of free markets, property rights, impartial contract enforcement, non-discretionary behaviour of public servants, and adoption of mechanisms for improving governance (public education, codes of ethics/conduct, robust civil society and media, and regional pooling of resources providing oversight). Infrastructure support, physical and social, will help reduce costs and could be a ‘driver’ of free markets and secure property rights. There also needs to be research into ways of improving political governance. Most of this assistance is not high cost, but it is heavily dependent upon good research and analysis, and is likely to make only slow progress.

All PICs have some natural resources that can produce sustainable revenue streams and provide some basis for economic growth. The atoll island countries, such as Kiribati and Tuvalu, are most disadvantaged in this respect, having only sea-based resources such as tuna. The Melanesian countries are endowed with natural resources—arable land, forests, minerals, and their exclusive economic zones. However, with the exception of minerals, these resources are poorly managed and revenue streams prone to mismanagement and corruption. The contracts with mining companies have improved greatly over time. They now ensure a fairer share of the resource rents accruing to governments and landowners and take good account of environmental issues. However, the resource rents going to governments and landowners from mining projects are not well managed, with existing arrangements for distribution and investment of these funds highly susceptible to mismanagement and corruption. Rents induce rent-seeking, particularly in the presence of weak institutions. Customary ownership allows those in authority to extract rents under the guise of ‘custom’. The contractual arrangements for the harvesting of logs and tuna, and the distribution and investment of revenue streams going to resource owners, leave a great deal to be desired.

Political instability has also presented significant obstacles to the micro-economic reforms that appear to be essential for robust economic growth and poverty reduction in the Pacific. The lack of political stability is mainly manifest in governments taking form through unstable coalitions. Globally, coalition governments have been less able than single-party governments to undertake reforms. Highly unstable coalition governments, as frequently occurs in the Pacific, find economic reform almost impossible; as the government can always be held to ransom by minority parties.

3.2.3 THE INVESTMENT CLIMATE

PICs face inherent difficulties in attracting investment and new jobs because of the high costs due to uncontrollable factors such as isolation from major markets, small domestic markets and frequent natural disasters. However, PIC governments have magnified these costs by restricting trade and investment and monopolies in telecommunications and other essential services. Where it has been possible, labour has migrated permanently, or taken up medium-term, off-shore employment. This phenomenon follows a global pattern of household risk diversification, which is income supplementing as well as providing protection against the high volatility of incomes due to factors such as natural disasters and commodity price fluctuations.

The conclusion that investment, especially private investment, is very low in PICs is inferred primarily from the low growth rates in formal employment, as data on public, private and foreign investment is very limited. Investment data are available only for Samoa, Tonga and Vanuatu. The investment/GDP ratio in Fiji is around 16 per cent, having risen from around ten per cent in 2001. Fiji's investment/GDP ratio was close to 30 per cent during 1979–81 but has fallen steadily since. It has been estimated by Rao (2004) that Fiji would need to achieve an investment rate of around 25 per cent to maintain a GDP growth rate of five per cent. Recently, only one-quarter of Fiji's investment has been private. Another one-quarter of investment is public investment in infrastructure. The remaining half has been invested in state-owned enterprises, many of which are performing poorly.

The investment/GDP ratios in Tonga and Vanuatu have recently been around 20 per cent. There are no data available to show the breakdown of investment into public and private investment in these countries. There are also no reliable statistics to show the extent of foreign investment in PICs. From observation in Fiji, it appears most foreign investment is going into the tourism industry. This is likely also the case in other countries with substantial foreign investment. Other foreign investment is most likely concentrated in local branches of international manufacturing industries, which are generally assisted through restrictions on imports. It is also likely that, similar to Fiji, a large share of public investment is supporting state-owned enterprises, rather than public infrastructure. There are no estimates of the extent of 'capital flight' from Pacific countries, which could indicate that domestic savers are confident in investing in their own economies.

Formal sector employment is also low in PICs and dominated by the public sector. Therefore, private sector employment conditions are generally linked to public service conditions. Public sector wages, often supported heavily with donor funds, such as in the US Compact countries, are considerably higher than private sector wages, which then has 'Dutch disease' effects. The absorption of some of the most qualified and enterprising Pacific Islanders in the large and inefficient public sectors and the emigration of skilled workers severely inhibits private sector development.

A basic institution of any society relates to property rights over land. In PICs, land, particularly land outside urban areas, is mostly held under customary ownership, to which there is strong cultural attachment. When population growth rates were very low, increasing land productivity was not important—especially in island countries with more fertile land. However, with increases in fertility rates and reductions in mortality (as a result primarily of clean water and sanitation), there is a need to increase land productivity. In the absence of some form of leasehold tenure to make land available to individual investors, customary ownership is most unlikely to be the basis for rapid increases in productivity and economic growth. Through the development of its leasehold system for customary land, Fiji was able to maintain a large sugar industry based on smallholder

farmers and is sustaining a large and growing tourism industry.

Land held only under customary ownership cannot be used as security for borrowing from commercial banks. However, secure, long-term, land leases—backed by government—can be as acceptable as freehold and used as collateral for commercial credit. The absence of long-term commercial borrowings by customary landowners in PICs is due to their inability to use their land as security. Also, without individual title landowners are not able to exclude others from the benefits of any investments of time and effort that they put into the land. Therefore, landowners' ability and willingness to make long-term investments in land, the basis for productivity growth, is limited.

Changes to land tenure in PICs will have to come from within and are likely to take considerable time. However, successes with individualisation of land tenure, such as with tourism, will foster interest in tenure change for other activities. It is also likely that government provision of infrastructure such as roads (which opens up land to commercial opportunities) and trade liberalisation (which opens up opportunities for exploitation of international markets and prices), will create pressure for secure individual land tenure.

Subsistence and informal sectors form a large part of economic activities in PICs. Because of the absence or limited extent of government welfare services, informal and subsistence sectors provide an important safety net for those who cannot find work in the formal sector. The subsistence way of living forms part of the rich cultural heritage of Pacific Islanders. However, growth of the subsistence sector is not a long-term solution to poverty eradication and community development in the Pacific. The transition from the subsistence to the formal sector will, over the long term, improve living standards, build investor confidence, broaden the tax base and increase government capacity for providing social services, reinforce the social contact between citizens and the state, and improve access to business services.

Several institutional barriers to the shift from the informal to the formal sectors may be encountered in PICs. These commonly include inappropriate administrative and regulatory barriers, regressive fees that penalise small firms, corruption in issuing of business licenses, lack of key business services such as finance and infrastructure, and socio-cultural barriers to people moving from communal ownership to individual ownership. Informal sector activity should be encouraged as it provides an important learning environment for future entrepreneurs and investors.

3.3 DOES AID CONTRIBUTE TO POOR PERFORMANCE?

The literature on links between aid and growth is substantial but inconclusive.³ The core question—does aid encourage growth?—is fundamental to interpreting the poor results of PICs over the past decade. If, as some contend, aid damages the economies, this has far reaching implications for regional donors. Indeed, some (for example Hughes, 2003) use these negative results to conclude that aid to the region should be drastically cut.

On the face of it, with high levels of aid but low levels of per capita growth, the interpretation that aid has not helped generate growth seems plausible. Recent international research by Raghuram and Subramanian (2005) provides a useful framework for examining this relationship. According to their research, aid has had an adverse effect on labour-intensive and export sectors in the developing world, largely through its impact on the real exchange rate. They note that this effect may offset the undeniably positive short-term effects of many aid projects and programs. Their findings are supported by an earlier study by Feeny (2004) who was unable to find a positive relationship between rural growth (clearly, a labour intensive sector) and aid spending in Melanesia.⁴ If these studies are correct, they have disturbing implications for long-term economic growth and income inequality. If sectors such as agriculture are placed at a disadvantage by aid spending, the majority

3 Amidst the claims and counter claims on whether there are robust links between aid and growth, Roodman (2004) concludes 'if there is one strong conclusion from this literature, it is that on average aid works well outside the tropics but not in them'.

4 Feeny did, however, detect evidence of an impact of aid on total growth—a finding which could perhaps be expected, particularly in states where aid is a high proportion of GDP.

of PICs will experience increasing inequality and, in all likelihood, increasing levels of instability.

On the other side of the argument, the majority of recent research indicates that aid and growth are positively correlated, particularly when aid is disaggregated according to its purpose (Clemens *et al.*, 2004). And, as noted, Feeny (2004) detects evidence of the growth impact of aid in Melanesia.

So, has aid been responsible for damaging economic prospects in the region? It would be foolhardy, given the liveliness and capriciousness of the debate, to come down on one side or the other. Moreover, definitive, high-quality evidence from the region has not been produced. Nevertheless, it seems fair to conclude that aid has not had the impact in the region that it should have had. What this points to is a need to pay much greater attention to the details of aid provision: where it can be used well; how much can be absorbed; how it should be delivered; and how it can be spent. It is not safe to assume that aid will always have a positive impact.

3.3.1 NEW ENTRANTS AND ESTABLISHED CHALLENGES

New donors are entering the region, including China, the Republic of China and, perhaps, India. Already, by indicating their intention to support maintenance of the Highlands Highway in PNG, the Chinese Government has signalled an approach to aid that could complicate attempts to encourage better financial management by recipients. Taiwan's support for the payment of compensation in the Solomon Islands provides another example of how aid can, in the wrong circumstances, add to a problem rather than solve it. India is making overtures in the sugar sector in Fiji that may yet be at odds with support offered by the ADB.

All donors will make mistakes. Provided that they learn from these mistakes, this may not be a problem. However, where the new entrants may create more significant difficulties is where they use aid solely to secure political support. Under these circumstances, new entrants could undermine the efforts of established donors like Australia and, quite possibly, set back prospects for sustainable development.

4 Prospects for growth in the Pacific Island Countries and agendas for change

PICs have been encouraged to pursue economic growth by opening their economies to trade and investment, and reform of the public sector. Is this reform agenda appropriate for PICs, however? Some argue that Pacific peoples do not wish to develop in the same manner as other countries. Others argue that the disadvantages these small states suffer mean they cannot compete on world markets and therefore their economies cannot grow in the way economies in other countries can. Therefore, where it is able to do so, labour will have to find employment in other countries and remittances from overseas workers and donor aid will have to sustain these PICs.

What are the likely prospects for growth in PICs over the next decade or so? Is it possible for them to muddle through as they have been for the past decade or so? What is needed for considerably improved economic growth performance that would lead to substantial reductions in poverty and less likelihood of further civil unrest?

4.1 A MUDDLING-ON SCENARIO

Given the continuation of aid and the existing emigration opportunities, most PICs should be able to muddle on, with likely continuation of the deterioration of services and increasing levels of poverty. With the ageing of developed countries, opportunities for off-shore employment for semi-skilled and skilled labour should increase. However, there will be continued growth of urban areas in

PICs and, with the loss of younger people from rural areas, ageing of populations in rural areas. Thus, the safety net of the village will not be so robust and groups most likely to suffer will be elderly women and children experiencing deteriorating education and health services.

Countries at most risk under this scenario are those with projected population growth rates in the two to 2.5 per cent range: FSM, Kiribati, RMI, Solomon Islands, and Vanuatu. With their poor capacity to absorb waste, the atoll island countries, Kiribati and RMI, face alarming infectious disease burdens and poverty if populations in their major urban centres continue to grow at recent rates. The land-rich Melanesian countries, Solomon Islands and Vanuatu, will be at most risk from political instability and law and order problems due to large numbers of unemployed youth and rents offered by the natural resource sectors. Poor economic growth will exacerbate these problems because the institutions expected to maintain law and order will be starved of funds.

Under this scenario, it is highly likely that conditions in traditional rural areas will continue to deteriorate significantly. Rural fertility rates are high everywhere. Without substantial rural-urban migration, the rural population growth rates will be in the two to 2.5 per cent range. Under the existing form of customary ownership of land, productivity increases are likely to be much lower than this. Therefore, the capacity for rural areas to meet needs will decline.

4.2 A SUSTAINABLE GROWTH SCENARIO

To move away from the present highly volatile situation of low average per capita income growth to a robust, sustainable economic growth path that will lift living standards on a widespread basis, PICs will have to increase private investment and productivity growth substantially, supported by effective physical and social public goods. Investment will have to be funded largely by domestic savings, although foreign investment can play a critical role by introducing new technology and skills, and providing access to global marketing networks. The levels of private and public investment needed to move to a sustainable, robust growth path are not clear, but from the limited evidence noted above, it appears a substantial increase is required.

The basic questions surrounding sustainable growth are: what do PICs have to do to encourage levels of savings and investment; and how can development assistance partners help in achieving these objectives? Specifically, what is required to overcome obstacles to higher growth?

Given their disadvantages in terms of scale of production and costs of transport, it appears that, with a few exceptions (such as coffee, cocoa, palm oil, and minerals) in some of the Melanesian countries, the PICs will always be uncompetitive in the production and export of standardised primary commodities. Competition in these commodities is largely through volume, standardised quality, and transport costs. Chand (2004) notes, industries established in PICs tend to ‘... be those requiring minimal economies of scale, such as small scale agriculture, boutique tourism, and assembly activity, such as clothing, and/or those with large rents, such as mining, forestry, and fishing’. Others receiving large rents from preferential prices and market access are sugar and tinned fish and import-substituting industries receiving protection from restrictions on imports.

To compete in world markets, PICs should concentrate on differentiated products with prices that more than cover high transactions costs.

Tourism, which is location specific, is one such product. Other export products are Fiji Water, Pure Fiji cosmetics, black pearls, and squash.⁴ The capacity for developing other differentiated products depends on freedom of entry of investment, entrepreneurship, ideas, and ease in establishing businesses.

As small, isolated countries, PICs’ greatest need for economic growth is to be able to exploit economies of scale by pursuing opportunities for marketing differentiated products available from trade with the rest of the world. To do this they need to be open economies. In fact, they probably have a greater need to be open to trade and investment than any other group of countries. Unfortunately, they are reluctant to open up to trade and investment. As well as raising costs for consumers, the use of tariffs or quotas to restrict imports taxes exports—directly by raising costs of inputs used by exporters and indirectly by leading to exchange rates that are higher than they would be otherwise. By not being open to foreign investment, new technologies, skills, and ideas that could help to overcome their natural disadvantages may well be excluded. For example, the widespread adoption of telecommunications monopolies, resulting in high costs of transmitting information to and from the rest of the world and within the country, is particularly disadvantageous at a time when cheap information transmission is playing such an important role in the location of economic activities. Similar problems exist with inter-island shipping, where national or provincial governments own ships they protect against competition.

A strategy for overcoming problems of geographical and economic isolation is deep integration of PICs, especially with their closest developed neighbours, Australia and New Zealand. There is renewed interest in regional pooling of resources in transport infrastructure such as shipping and aviation—a concern relating to PICs’ geographical isolation. There is also wider discussion of the benefits of deep economic integration of the small Pacific states with Australia and New Zealand, stimulated by the recent

⁴ Amidst the claims and counter claims on whether there are robust links between aid and growth, Roodman (2004) concludes ‘if there is one strong conclusion from this literature, it is that on average aid works well outside the tropics but not in them’.

publication of an Australian Senate report on aid in the Pacific (Australia 2003). Economic integration with Australia and New Zealand could extend beyond open trade and investment to freer migration of labour and the adoption of regional economic institutions such as a single central bank and a common currency such as the Australian dollar. The regional trading arrangements PICs have entered into (such as the Melanesian Spearhead Agreement and the Pacific Island Countries Trade Agreement—PICTA) are limited and designed to proceed slowly. They offer little scope for improving human welfare while having potentially significant costs in the sense of creating antipathy towards further trade liberalisation.

While PICs share many economic characteristics, they are different in other respects and not necessarily able to follow the same development path. Some are much smaller and more isolated than others, for example. The atoll island countries have limited prospects for agricultural development when compared to the land-rich Melanesian countries and, because they find it difficult to absorb waste, are limited in the industrial activity that can be undertaken.

However, even for the smallest and most isolated PICs, being open to trade and investment is important. Prohibitively high transport and production costs prevent them from benefiting much from exports. The other side to this is that domestic industries have high levels of natural protection against imports. Thus, providing tariff or other import protection to domestic industries only serves to raise the costs to other producers and consumers already suffering the costs of isolation and small markets. It may be argued that removing the tariffs protecting domestic industries will eliminate a key component of government revenue. However, tariff revenue can be easily replaced with a value-added tax. Or, if there are few local industries a flat revenue tariff will accomplish the same task while having lower compliance costs than a value-added tax.

Openness to foreign trade and investment is just as critical for the larger PICs. As noted above, given their geographic isolation and smallness, many PICs can never hope to compete in open markets in the supply of unprocessed primary commodities—with

the possible exception of tuna. The only way they can benefit from trade is by establishing markets for differentiated products with prices that more than compensate for high production costs. To achieve this goal, these PICs must benefit from the skills, technology and ideas that flow from free enterprise and openness to foreign trade and investment.

It is possible that without an appropriate institutional environment the response to trade and investment liberalisation will be limited. A concern is that potential investors cannot acquire sufficiently secure title to the land they need to make investments viable. They will only therefore invest if insured against this risk by government subsidies or other assistance.

Fiji has shown the way for other PICs in developing individual leasehold tenure within the framework of customary ownership. Other countries could follow this example, maintaining customary ownership and the peoples' relationship to the land as well as making land available for more productive investment. However, there are problems with Fiji's system—such as the monopoly of the Native Lands Trust Board over the allocation of leases and the limited transferability of the leases—which have to be resolved if Fiji is to create a more favourable investment environment. Insecurity over land for investment is widely blamed for Fiji's low investment to GDP ratio, which is now one-third what it was in the 1970s. Other PICs are examining and implementing ways to mobilise land for productive activities.

Insecurity of individual tenure to land is very likely limiting growth in the productivity of agriculture in PICs through depressing individual effort and access to credit and thus investment. If the land-rich countries of Melanesia are to prosper and to have improved food security, economic growth must be built upon robust growth in the rural sector. Thus, investment in research and development of new and improved crops and improved farming systems are important, as are improved access to markets and rural services. Agricultural departments and agricultural research are under-resourced and under-developed in PICs and could benefit from more government and agency support. However, without security of tenure, only research into technologies

with rapid pay back periods will be worthwhile. Also, benefits of investment in infrastructure will be limited.

As AusAID's (2004) *Food Security Strategy* argues, openness to imports is an important component of a food security policy. Imports can be a cheaper and more effective means of meeting consumers' food needs than domestic production. They can also complement domestic production and provide price and quality discipline for domestic producers. While food self-sufficiency from domestic production should not be the goal of policy, this production should be as efficient as possible—this will only be achieved through effective agricultural research and development policy.

But for land-poor, atoll island countries, domestic agricultural production may be able to play only a small role in achieving food security, given the limited scope for increases in agricultural productivity. For some of these countries, food security may be best achieved through increases in incomes from non-agricultural activities. However, for some of the smallest, most isolated micro-states that face the highest costs in international trade, making the most of agricultural resources may be the best food security strategy. For some of these states, community-sustaining donor aid and remittances may be the only way to maintain viable communities.

The shift to more open economies will take time: time to change views towards markets and the private sector; time to develop the institutions that underpin effective markets; and time to adjust the economic structure. The role of development assistance partners in facilitating this shift needs to be researched and prioritised. Consideration of the type of assistance required during the adjustment period is also needed. While countries performing poorly need help to avoid reforms adversely affecting the most disadvantaged, assistance should not reinforce existing obstacles to the economy moving onto a higher economic growth path.

There is a strong commitment by development assistance partners to overcoming HIV/AIDS in PICs. Judging by experience in other developing countries, HIV/AIDS poses significant risks to Pacific economies and populations. However,

malaria has been an ongoing cause of substantial human costs in Melanesian countries through its high incidence of mortality as well as through the hidden debilitating impacts on physical and mental development of its peoples and the adverse effects on investment. Unfortunately, there has not been a similar commitment to overcoming malaria in the region as there has been in the case of HIV/AIDS.

The increasing incidence of infectious disease in several Pacific countries is alarming. The reduction in infectious diseases in developing countries, even in the least developed, that led to substantial reductions in infant and maternal mortality and increases in life expectancy, basically resulted from providing increased access to clean water and sanitation (what some have called the greatest advance in medical history). That infectious diseases are increasing in PICs sends the signal that they are going backwards in providing access to clean water and sanitation. If aid has been effective anywhere, it has been in its contribution to providing clean water and sanitation throughout the developing world. Therefore, it appears that development assistance could make a significant contribution to improving the investment climate in the Pacific by refocussing its efforts in these areas.

5 The role of donors in achieving higher growth

PICs are not performing to their potential. Some, particularly the micro-states, face an uphill battle because of high business costs and limited scope for diversification. Yet there is no reason to saddle themselves with weak policies too. Others, notably the states of Melanesia and the larger Polynesian countries, have the potential to be strong, independent and prosperous. Whether they will achieve this depends on their capacity to adopt appropriate institutions and policies. This section looks at what the donor community can do to support PICs in achieving higher growth.

5.1 THE APPLICATION OF GOOD AID PRINCIPLES

The poor economic growth rates of PICs (Section 3) suggest that the effectiveness of aid has been limited. Whilst the evidence is nowhere near robust enough to suggest that aid should be curtailed, it does highlight the need for aid to be used more effectively.

Regional donors acknowledge that improvements are needed. For example, ADB (2004) noted that their past programs failed to adequately account for the importance of broad consultation and strong political ownership of reform, and the need for deliberate, well structured approaches to building institutional capacity. It also hinted at excessive use of consultants, contributing to unsustainable

outcomes. The World Bank (2005) says it has focused too much on inputs (usually technical assistance) and failed to specify and monitor against clear, achievable objectives. It says it has not invested enough in developing relationships and following through with implementation of recommendations. AusAID (2004) notes different lessons, particularly the importance of investing in the right sectors and retaining flexibility. Other donors have remarked on the agency's tendency to use technical assistance (particularly Australian) to the exclusion of other forms of assistance.

Lessons from other parts of the world that have resonance in the region are poor alignment of donor and recipient government policies, frequent proliferation of donor activities and insufficient policy coherence within and among donor activities.⁶ Together, these lessons point to a new agenda for donors in at least four areas: enhancing demand for changes in institutions, policies, and service delivery; improving donor coordination; better aligning donors' assistance with recipient countries' development strategies; and improving the monitoring of donor performance.

⁶ Indeed, OECD/DAC figures show an extraordinary proliferation of projects in just one sector—education—between 1997 and 2003. Although the figures are inflated by small French projects, there have been no less than 109 education sector projects in this period in Vanuatu, 70 in Samoa, 50 in Tonga, and 46 in Kiribati.

5.1.1 PARTICIPATION AND THE DEMAND FOR CHANGE

The changes needed to establish effective institutions that support private sector-led growth and to strengthen service delivery will challenge many vested interests. Indeed, the high concentrations of government-to-government aid in the region have helped to limit the debate about change to government and donors, rather than to extend it to the broader populace. Moreover, the weak performance of labour-intensive and export industries deprives PICs of an important constituency for good governance—that is, businesses with a vested interest in open markets. Whilst donors are rightly concerned about local political ownership for change, this is difficult to achieve; the incentives simply are not sufficiently strong.

The key to achieving change in PICs is to support the demand side of the equation, in particular mobilising electorates to demand better performance from governments. For donors this means engaging far beyond the usual confines of central agencies. It means encouraging consultation and participation in the design and evaluation of public policy, stimulating greater levels of communication between governments and electorates, and seeding effective and informed engagement by the media.⁷ It also means ensuring there is adequate feedback to electorates on progress with policy implementation and clear incentives for the electorate to press their governments to improve quality of services. Critically, it also means donors need to understand when their support undermines these natural forms of accountability within a country, for example, by reducing the need for governments to raise taxes, and therefore to explain themselves to taxpayers, or by pre-empting the resolution of a crisis through premature assistance.

For donors, this kind of participation requires a substantial investment of time and (often local) expertise. Yet donors often cut corners, impose inflexible deadlines, vest responsibility for consultative processes with inexperienced agents, and speak only with counterparts in central agencies

rather than the broader population. Such practices must change if donors are to cultivate local demand for change.

5.1.2 DONOR COORDINATION

The limited information available on donor coordination indicates that coordination remains problematic and impedes attempts by donors to support development across the region. Ideally, coordination should be imposed on donors by an effective government aid coordination unit. In the Pacific, however, these units often face capacity constraints. A first step is therefore to ensure that appropriate support is available to aid coordination units in governments in PICs.

On the supply side, some donors are making sensible moves in experimenting with harmonising programs (New Zealand, Australia and the United Kingdom), in decentralising their operations to the region (World Bank and ADB), and in holding regular informal meetings. But there is no systematic attempt to monitor coordination across the region, so donors remain unaccountable for their actions. A regular, formal, and, preferably independent, assessment of levels of coordination would help to establish targets and benchmarks.

The risks of deterioration in donor coordination are high, given the likely increasing role of new donors in the region. Established donors have perhaps been too insular in their efforts. Substantial work is needed on their part to engage the new donors and to share lessons. Considerable humility is required—even established donors cannot point with confidence to the effectiveness of their efforts. Indeed, even established donors frequently remain unwilling or unable to share information about their intentions and activities.

7 Critically, this has been one of the key innovations of the processes of creating locally-owned Poverty Reduction Strategies elsewhere in the developing world. Such processes are based around a broad-based consultation with electorates. They are designed to be nationally-developed documents, not run-of-the-mill policy pronouncements.

5.1.3 ALIGNMENT WITH RECIPIENT COUNTRIES' POLICIES AND APPROACHES

Governments in the region are small and generally weak in technical capacity. Donors' preference for projects exacerbates this by bypassing established systems, imposing alien procedures, undermining traditional accountability processes, and generally increasing transaction costs faced by recipient governments. Were more donors to adopt programs—including sector-wide programs—this potentially damaging impact of behaviour could be reduced. Moreover, by using established government systems and local processes of accountability, systems would be strengthened.

This approach demands a major change in mindset by donors. It means that the favoured, frequently *ad hoc*, approach of supporting individual technical assistance opportunities and projects should increasingly be replaced by more complete, medium-term programs. The key point is that donors need to come in behind comprehensive, plausible and well-planned strategies that have been developed by recipient governments. Without this level of recipient engagement, the risk is that donor activities will continue to parallel, rather than support, government processes. Alignment should not stop at matching policies and processes. It must also address more effectively the capacity constraints inherent in the region's governments. Here, donors must pay more attention to the ability of PIC governments to pay for and effectively staff their often swollen bureaucracies. Over-large public services are a feature of the region.

5.1.4 PERFORMANCE MONITORING

The absence of systematic monitoring of donor performance in the region severely reduces the potential impact of donor funding. Particularly in the area of support to governance, where there is so little clear guidance on how to engage, donors have to be more systematic in approach. They must establish clear monitoring frameworks in advance of implementation and, ideally, these frameworks should build on established local systems. At the very least, they should include a significant role for the proposed beneficiaries of their programs. They

must share this information widely, so the lessons of all donors can inform choices and donors are encouraged to become more accountable. ADB, AusAID and the World Bank are all committed to improving monitoring their new strategies. At a minimum, this information needs to be shared publicly.

A further challenge is noteworthy: the quality of impact data such as the indicators used for the MDGs is weak across the region. The absence of necessary data is likely the main problem, but comparability of data across countries is also problematic, so benchmarking is seldom feasible. A significantly enhanced effort is required to generate accurate, easily accessible statistics on development progress.

5.1.5 DO NO HARM

The principle of 'do no harm' has become standard in dealing with post-conflict environments. In essence, it provides explicit recognition that such situations are inherently complicated, and that even well meaning donors can make matters worse. As section 2 notes, aid effectiveness research suggests that the long-term consequences of poorly executed aid can also be harmful. This suggests that donors need to adopt a clear means of assessing the risk that their programs will undermine long-term progress. Such an approach should be developed and implemented through a collective effort between all donors, with appropriate input from the recipient countries themselves.

5.2 SUPPORT FOR BETTER GOVERNANCE

The primary challenge for donors is how to support better governance in the Pacific. There are no easy or quick fixes. Collective experience demonstrates the importance of strong local ownership of, and demand for, reform, which relies on a much more effective level of engagement of local communities than has been practiced to date (by donors and recipient governments). Reform cannot be forced on governments by donors, which also means addressing the danger of elite capture. Winters (2005) notes that the small, undiversified economies

are particularly prone to elite capture of aid and highlights the divisiveness it can cause.

Yet the region is littered with good locally-owned policies that have not been implemented. So a focus on implementation is needed. This means ensuring that implementation is transparent, accountable and consistent with agreed priorities. Mentoring assistance to those charged with implementing policies would be helpful. A more engaged and better-informed civil society, a vibrant and independent media, and a competent and effective government statistical capacity are essential. Essential, too, is support for the evolution of more appropriate political systems that challenge the disastrously high levels of political instability associated with many nations in the region. Little can be achieved without strong local pressure for change. Where this is absent, donors should restrict themselves to supporting research and education.

Support to encourage stronger management of public expenditure and reduce corruption is essential to governance reform in PICs. Even here, however, the challenges are not so much about the technical qualities of the governmental systems as they are about understanding the pressures on those systems and the minimum requirements necessary to address those pressures. For example, there is an increasing level of concern that over-complex systems of budgetary management are being established, with little realistic hope of developing countries ever being able to properly resource and manage them (see, for example, Grindle 2004). This is a risk for small countries, which do not have the scale to accommodate and stimulate specialisation and which are afflicted by substantial brain drain.

Since donors have little scope to press reluctant governments and their electorates to change, it is essential that they become sufficiently nimble to exploit opportunities when they present themselves. This might come in the form of a more accommodating government, reform-minded ministers and senior civil servants, or even through a sudden collapse in service standards or a fiscal crisis. Such responsiveness can only be achieved if donors have a better understanding of the way societies in small states operate, cooperate, and compete, and a far stronger understanding of their political

economies. In turn, this requires knowledge about the countries concerned: knowledge that in many cases is most likely to be reside with local people.

5.3 SUPPORT TO IMPROVE THE INVESTMENT CLIMATE

The institutional changes necessary to support private sector growth across the region were documented in the ADB (2004) report *Swimming Against the Tide* and will be a focus of AusAID's Pacific 2020 report at the end of the year. The ADB report concludes that a successful strategy to promote private sector development in the Pacific will require sound macroeconomic policies, more appropriate regulation of business—including reduction in the numbers of uncontested monopolies—and effective legal and regulatory frameworks.

Both the ADB and World Bank have shown strong leadership in analytical products to support change in this area. Both are following up with technical assistance to support that change. Such analysis and support remains essential. Moreover, an important characteristic of much of this work is its amenability to outcome measurement. Donor input in this area is an obvious place to start with a more disciplined, results-based partnership with PICs.

While some necessary changes, notably in relation to regulations, can be relatively quickly addressed, others, such as the development of more effective financial markets—consequent largely on the capacity to collateralise land—or, indeed, the reduction in political instability, will take far longer to realise. The issue for donors is to support PICs in developing clear, prioritised strategies for encouraging investment in areas in which they have (i) comparative advantage and (ii) niche products for which premium prices (that compensate for the innate high costs of conducting business) can be charged.

5.4 SUPPORT TO SERVICE DELIVERY

Stronger governance and improved investment environments will, over time, bring about robust per capita growth rates that allow serious progress

towards improved living standards for all and improved political stability. But they will take time to have an impact. During this time, the majority of the population will continue to experience poor quality services and young people will continue to be unemployed. So there is a strong case for maintaining a focus on service delivery.

Recent research from the World Bank suggests that funding for services in the region may not be the main constraint. Rather, weak governance undermines the ability of governments to invest productively in health, education and infrastructure. There is scope for donors to redouble their focus on opportunities that exist to improve service quality, particularly across areas such as decentralisation of delivery, strengthened public expenditure management, and better control of corruption. Also, scope exists to improve the accountability of service delivery agents themselves, building on experiments with accountability by providing information to client groups.

Also in the area of service delivery, interest is now being shown in opportunities to reduce costs and improve effectiveness of services through regional actions (including through the Pacific Plan). This is an important for donors; their sustained, informed and sensitive engagement with the Pacific Plan will help to build support amongst regional governments.

5.5 DONOR COORDINATION

Donor nations can help not only through the direct investments undertaken through their aid programs. They can also support development by ensuring their domestic policies are consistent with improved policies in the PICs. In particular, donors' trade policies can often be restructured to support the kind of outward-looking, open trading regimes that will be necessary in the PICs for sustained growth.

An opportunity exists in relation to market access for overseas workers from the region. The temporary movement of labour around the world is thought by many observers to be key to the economic prospects of the developing world, particularly small island states with high birth rates and very limited domestic employment opportunities (Winters *et al.*, 2003). Accredited training of Pacific Islanders in skilled occupations such as nursing, teaching and the building trades could benefit both the PICs and the metropolitan countries.

6 Implications for the Australian aid program

AusAID's *Pacific Regional Strategy* (2004) provides a broad framework for engagement with the region over the next decade. Its focus on governance is appropriate, as are its four themes: (i) stronger broad-based growth; (ii) more effective, accountable and democratic government; (iii) improved law and justice and security; and (iv) enhanced service delivery. The DAC (2004) peer review of the Australian program concluded that Australian support was of a high quality, particularly in HIV/AIDS, approaches to fragile states, peace building, and conflict resolution. Internal reviews, too, have endorsed the focus of core elements of the program.⁸ New departures, such as the Regional Assistance Mission to Solomon Islands (RAMSI), have also been broadly welcomed.

Nonetheless, over the past two years the weakness of the region has become more pronounced and the threats this poses more acute. Analytical insights, too, have moved on—there is a clearer view about the deficiencies in the region's investment climate. The high cost of intervention when conflict and state breakdown occurs has been demonstrated by RAMSI and, in different ways, in Nauru. In short, the true, fundamental nature of governance challenges has become more apparent. The impact these weaknesses have had on growth prospects, and therefore on stability and security, is palpable.

As the previous section argued, this requires a shift in the approach of all donors, focusing more on good aid practice, governance and the investment climate, and making sure service delivery becomes more efficient and effective. More broadly, developed countries need to pay attention to coherence of policies, in particular trade in services.

For the Australian program, donor-wide shifts are relevant. Since Australia's foreign policy interests are closely tied to the region's fortunes, the development program must continue to contribute effectively to government policy objectives. In the opinion of this review, this requires action in the following eight areas.

6.1 MORE EFFECTIVE INTEGRATION OF THE GROWTH OBJECTIVE

Australia's objective of a prosperous, secure and stable Pacific region will be most effectively met through encouraging higher levels of growth. Indeed, unprecedented levels of five to seven per cent growth are needed to ensure improved living standards for all, to make a significant dent in poverty and to improve political stability. Over the next decade, the Australian program needs to develop more effective ways of addressing and integrating this growth objective.

⁸ A cluster evaluation of public sector reform programs in the Pacific region conducted in 2003 found that four out of five programs were satisfactory or above.

The pre-conditions for more rapid, sustained growth are: (i) removing obstacles that prevent the majority of the population from participating fully in the economic growth process; and (ii) creating a private investor-friendly environment. In this effort, governments have important roles in enhancing the physical and social infrastructure and providing the necessary regulatory framework to ensure healthy competition.

Recommendation: First, country strategies need to focus more explicitly on growth and identify how it is generated and shared, particularly in labour-intensive and export sectors. This analysis must address the issue of how growth can be stimulated and should directly address the question of aid quality, that is, the degree to which aid spending could threaten growth. Second, Australian country strategies should ultimately come in behind credible, costed, country-owned growth strategies. Where these do not exist, Australian aid should look for opportunities to support their development.

Just as country strategies must be explicit about the growth linkages of their proposed investments, so too must they improve the quality of their poverty analysis and, crucially, links between this analysis and the proposed program. Meeting this objective demands better information on numbers and trends in poverty and inequality. These should form the basis of regular updates on the extent of regional poverty. Because regional social security networks are complex and can change quickly, so too numbers of poor people and local concentrations of poverty can change rapidly. Where such information does not exist—which is true for the majority of PICs—additional support for national data gathering on poverty is required.

6.2 BUILD HUMAN CAPITAL FOR PROGRESSING GOVERNANCE

While specific policy responses for strengthening governance in the region may not yet be clear, elements of the process are unequivocal. In general, the quality of education, at all levels, must be improved if Pacific peoples are to participate fully in the opportunities offered by domestic and global markets in the 21st Century. They must also be

able to understand their rights and responsibilities as electors and monitor the performance of their governments. In particular, good governance will demand strengthened human resources in three core areas: leadership, institutional analysis and policy analysis. The shortfall in leadership skills in small countries is to some extent inevitable. Nonetheless, it is such an important area that efforts to overcome this weakness must be a priority. With policy and institutional analysis, regional institutions simply have not been able to generate sufficient, high-calibre individuals to staff central agencies, think tanks and consulting groups.

Recommendation: There should be a detailed review of the education systems in each country to identify weaknesses leading to the poor outcomes identified by the World Bank (World Bank 2004). Besides this, three other areas require attention:

1. A systematic leadership development program needs to be developed in conjunction with relevant regional bodies.
2. A program of development of policy analysis skills should be established, perhaps mainly through an external tertiary institution. Such a program would profit from close links with policy areas of developed countries in the region, including Australia and New Zealand. The issue of appropriate (that is, attractive) remuneration on return to home countries will need to be addressed as part of this program.
3. A need to build up the capacity of the IMF-managed *Pacific Financial Technical Assistance Centre* to establish a larger, dedicated team of public finance and statistical experts, based, potentially, across three sites in the region, perhaps broadening the scope beyond conventional IMF practices. Such a resource would establish a regional mechanism for solving some of the skills shortages that prevent governments from undertaking effective public financial management and collecting and publishing the reliable statistical information essential for effective analysis and policy making.

6.3 MORE EFFECTIVE PERFORMANCE MONITORING AND MANAGEMENT

The challenge of supporting improved governance, a stronger investment climate and higher growth in the region is complex. With no blueprints, let alone consensus on what might work, it is essential that there be a comprehensive performance management system in place for the assistance program. Such a system must track activities, isolating success factors and reasons for failure. Insights should be shared internally as well as with other donors and with recipient governments.

Recommendation: The commitment in AusAID's *Pacific Regional Strategy 2004–2009* to improve performance measurement is timely and appropriate, and the appointment of a regional performance adviser will improve AusAID's capacity in this area. Given these commitments, AusAID should soon be able to demonstrate changes to its performance monitoring system. Internal improvements notwithstanding, there is also a strong case to support the development of an independent regional capacity to monitor aid effectiveness. This would help establish benchmarks for donor performance and strengthen accountability for recipients and donors alike. Elements of such performance monitoring may be implemented through the monitoring system to be established within the Pacific Plan.

6.4 AN ENHANCED FOCUS ON PUBLIC SECTOR MANAGEMENT

Reform of public sectors in the region is essential to improve the environment for private sector growth and to enhance the efficiency of public services. Variants of the Australian model of public sector reform appear applicable in PICs, albeit at much reduced levels of complexity and resource intensiveness. In particular, Australian systems are noted for the strength of their budget systems and the effectiveness of their public expenditure management. Australian government agencies with expertise in these areas, especially the Australian and state and territory departments of Finance and Treasury, have begun to engage more coherently across the region. Importantly, other donors

recognise the value of Australian experience and expertise.

But there is scope for the Australian program to play a stronger, leading role in relation to public sector reform. To do this, the program needs to build on expertise in the technical areas of public sector management. It must also be seen to adapt these skills so they are more appropriate in developing country contexts, particularly to accommodate the smaller, less technically advanced nature of regional systems and their limited access to resources. At the same time, more attention is needed on the demand side of public sector reform. This will require imaginative, innovative approaches to engaging civil society and to challenging vested interests, particularly those associated with the region's overlarge public sectors.

Recommendation: Australia should consider how it could play a more authoritative role in supporting public sector reform in the region. This is likely to require action on several fronts. In discussion with other donors, it needs to explain and assert its intentions to lead in this area, including clear statements about the (lengthy) time horizons over which this type of engagement will be necessary. In Australia, new relationships between AusAID, the departments of Finance and Treasury, relevant state and territory governments, and educational bodies will be needed to generate the technical advice to support this strengthened focus, and possibly to train the technical staff needed in PIC governments. More innovative relationships will be needed with civil society across the region, to harness and focus demand for change. Links with the World Bank and the ADB will also need to be strengthened to allow Australia's new intent to be guided by international experience. Benchmarking and performance monitoring will be essential to demonstrate to electorates the benefits of, and scope for, public sector reform.

6.5 LEADING DONOR COORDINATION

The challenge of coordinating donors working in the region is significant and growing. A greatly increased effort is required if the detrimental impacts of multiple, uncoordinated donor programs are to be

prevented. From the donors' side, such coordination is rightly the preserve of the Australian program—it has the aid infrastructure, the scale and the proximity to do this. Moreover, as one of the leading donors to both the IDA and the ADF, it has the financial credibility and authority to play this role.

Recommendation: If Australia is to play such a role, it will need to invest more heavily in understanding the structure, motivations and modalities of regional donors. It will also need to pay far greater attention to its own capacity to integrate with other donors; credibility will be at stake if Australia cannot practice what it preaches. Clear indicators of the quality of coordination will need to be developed and used to measure performance.

6.6 CONFRONTING VULNERABILITY

Even where governments follow correct procedures for strengthening their economies, they are still liable to setbacks caused by natural disasters. This was amply illustrated by cyclone Hetta wiping several percentage points of GDP growth from an otherwise well-managed Samoan economy in the early 2000s. While Australia provides generous and prompt assistance for these emergencies, there may be scope for additional policies that enable recipient governments to play a greater role in managing emergencies.

Recommendation: One possibility for greater self-management is self-insurance, whereby countries could establish trust funds to be used only in the event of a natural disaster or external shock such as a commodity price shock. These funds could be made up from windfall gains realised by the countries themselves, for example, from fishing revenues and from donor funds. Another possibility is more in the way of insurance provided by donors, such as in the form of a 'Pacific Vulnerability Fund'. This fund could apply across the region and be accessed by governments that experience particular external shocks, subject to the agreement of a fund management group that includes donors and civil society representatives, and has a clear set of guidelines on when payouts could be made.

The fund could be replenished in two ways—through direct injections of cash from donors to support crises, and through the diversion of funds from other uses. In the latter case, for example, the fund could be supplemented by donors when a recipient government was deemed to be likely to use funds inefficiently. For example, if corruption cases were not being prosecuted, and a donor felt it would not be wise to maintain funding to a sector program, the funds could still be earmarked for use by the government but placed in the vulnerability fund.

6.7 INTEGRATING REGIONAL GOVERNANCE

Regardless of their quality, small governments are more expensive than large ones. The reason is that fixed costs, such as developing new policy, are shared amongst fewer taxpayers. This fact-of-life for PICs is one motivation that lies behind the development of the Pacific Plan and its attempts to establish regional (shared) approaches to providing a range of government functions. However, the trade-off is, in some sense, a loss of sovereignty.

Recommendation: The Australian program lacks a coherent analytical framework to determine whether, in any given case, regional or country-specific solutions are appropriate. Using the analytical work completed for the Pacific Plan as a guide, AusAID should develop a clear framework of its own. This could lead to significant changes in the way assistance is delivered.

6.8 BUILDING PARTNERSHIPS IN THE AUSTRALIAN PROGRAM

The effectiveness of Australia's aid program suffers from Australia being the dominant power in the region. Its position inevitably attracts scepticism of its motives and resentment of its authority. But the Australian program risks exacerbating this situation through some of its work practices. Much Australian-sourced technical assistance is supplied through large contracting companies. These companies are highly efficient at procuring and deploying expertise. The problem is they can complicate the management and accountability of that expertise. This happens when TA is formally responsible not to

the recipient government but to their contractor. The perception—whether accurate or not—is of a parallel management and accountability structure over which recipient governments have little authority. Such perceptions have been entrenched by the almost exclusive use of Australian expertise, and by a lack of clarity about Australian objectives.

It is commonly claimed that Australia aid is boomerang aid, implying that benefits accrue to Australians and Australia because the goods or services provided are sourced in Australia. This is a nonsensical statement that does not recognise that goods or services have been delivered to the recipient country. The correct issue is whether the goods and services delivered have maximised the value of the aid funds.

The key issue is whether there would be benefit in untying aid so it could be sourced from outside of Australia as well—including from within the recipient countries. This review believes there would be benefit in fully untying Australia's aid and opening it up to international tender.

Recommendation: A major new effort is warranted to strengthen the image and practice of Australian aid to the region. A greater diversity of technical advice is needed, including from the region itself. Improved ways are needed of using technical assistance, whereby recipient governments become more instrumental in their management. As well, Australia should be clearer about its objectives, in particular its strategic objectives, in the region. Finally, Australian aid should be fully untied.

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Glossary

ADB	Asian Development Bank
FSM	Federated States of Micronesia
MDGs	Millennium Development Goals
NGO	Non Government Organisation
PICs	Pacific Island Countries
PICTA	Pacific Island Countries Trade Agreement
RAMSI	Regional Assistance Mission to Solomon Islands
RMI	Republic of the Marshall Islands
SPC	South Pacific Community
UNDP	United Nations Development Programme
VAT	Value Added Tax



Australian Government
AusAID

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Papua New Guinea

Analytical report for the White Paper on
Australia's aid program

Prepared by
Professor Alan Morris and Rob Stewart

SEPTEMBER 2005

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Executive summary

OVERVIEW

Papua New Guinea (PNG) faces enormous development challenges. The country continues to confront difficult economic circumstances, there is widespread breakdown in service delivery and the economic and social impact of the emerging HIV/AIDS crisis will intensify in the next three to five years. PNG has the worst social indicators in the Pacific, and its human development indicators remain poor relative to its per capita income.

PNG's population has almost doubled, from 2.9 million at Independence, to 5.5 million in 2003, growing at an average rate of around 2.7 per cent per year. Forty-one per cent of the population is under the age of 15. The country's rapidly growing population is adding significantly to the burden of delivering essential social services. The emerging HIV/AIDS epidemic could have a substantial impact on population growth in the period ahead.

Women are particularly disadvantaged with lower life expectancy, significantly lower participation in the education system and high rates of maternal mortality.

Trend growth slowed from around six per cent per annum in 1960 to around two per cent in 2002. From 1991 to 1994 the economy grew rapidly, largely due to strong performance in the petroleum and mining sectors. Between 1995 and 2002 the economy contracted in all but two years. High inflation and rapid population growth meant that

per capita incomes fell an estimated 18 per cent between 1994 and 2002. In US\$ terms per capita income in 2003, at US\$510, was substantially less than it was in 1975 (US\$560).

The 2005 National Budget projects growth to continue over the next five years, with non-mining real GDP growth forecast to grow by 2.8 per cent in 2005 and from three per cent to 3.5 per cent over the period 2006–2009. With the projected rapidly increasing population, economic growth of around three per cent will be insufficient to yield significant increases in per capita incomes over the medium term.

PNG's fiscal outlook will remain constrained for the foreseeable future. Funds available for the delivery of goods and services are likely to diminish beyond current levels—levels already inadequate to meet the reasonable needs of the population. PNG's capacity to improve standards of service delivery across the country over the next five years is expected to decline, not strengthen.

PNG's medium term economic outlook is uncertain. Current economic recovery is fragile and significant endogenous and exogenous impediments to higher levels of sustainable growth remain. Developing broader sources of growth, particularly in rural areas where the majority of poor live, must be a priority if PNG is to make real gains in addressing its poverty problems.

Eighty five per cent of the population live in rural areas. The rural population grows almost all its own food, and uses money from the sale of cash crops to meet some proportion of education and health care costs. This is an important source of stability to the nation and provides employment to a large number of the work force, including, importantly, large numbers of young men.

Village agriculture is also important to the overall stability of PNG. Even on the most favourable assumptions about growth, village agriculture will continue to sustain the overwhelming majority of Papua New Guineans for the foreseeable future.

POSITIONING THE AID PROGRAM TO SUPPORT GROWTH

Clearly defined strategies for growth, backed by consistent implementation of priorities to generate it are required. Lack of strong and consistent linkages between the last Medium Term Development Strategy 2005-2010 (MTDS) and the annual budgets undermined the effectiveness of the MTDS process. At this time, and notwithstanding the emphasis given to growth in the MTDS, specific strategies, assurance of funding, and commitment to implementation are inadequately developed.

The PNG Government supports developing infrastructure, particularly roads (but also communications, airports and sea ports), as a key priority in generating stronger growth. Adequate infrastructure to link people and products to markets is a precondition for growth and should be a strong focus of the aid program. Improved infrastructure also facilitates access to better services, particularly for the rural majority.

Generating sustained broad-based growth cannot be achieved without a focus on overcoming the constraints which hinder wider growth opportunities. Attention on binding constraints is a must. The aid program must support the identification of priorities and work in concert with the Government and other donors, to support the effective and consistent implementation of initiatives to address them.

POSITIONING THE AID PROGRAM TO SUPPORT POLITICAL GOVERNANCE

PNG is still a young nation and the integration of its fledgling formal institutions with pre-existing social forms is far from complete. The impact of interventions to strengthen governance will be gradual and long-term. Expectations should be realistic.

PNG has many institutions designed to support effective governance. They are generally weak and are given little committed support or effective follow up.

PNG church agencies provide around 40 per cent of school education and 45 per cent of health services across the country. Many in Australia and PNG ask whether aid should be supporting non-government organisations (and, in some cases, the private sector), to play a stronger role as alternative channels for service delivery and/or as agents to demand greater transparency, accountability and stronger performance from Government.

With the exception of churches, non-government organisations in PNG are not large or well organised. Their reach—geographic coverage and sectoral involvement—is limited. Community organisations can undoubtedly provide effective service delivery in pockets, but none offer wide-reaching delivery networks. If given a much more demanding mandate, there is little reason to believe they would not end up suffering from the same weaknesses as government systems, including weaknesses in governance.

More widespread use of NGOs in service delivery would weaken the pressure on Government to perform and would leave Australian aid at the sharp end of service delivery. It is logical to view these organisations as important and valuable partners of government and donors in a more effective service delivery network, and to support them in areas (geographic and sectoral where they demonstrate strengths, but not as alternative networks which might replace government systems.

As an issue of political governance, arrangements under the 1995 Organic Law on Provincial and Local Level Government need to be reviewed. Implementation of the Organic Law provisions

has been haphazard and inconsistent. Confusion remains over responsibility for many functions and funding arrangements have proven unaffordable and inequitable. This has led to large inequities between provinces, weak governance and deteriorating service delivery.

POSITIONING THE AID PROGRAM TO SUPPORT STABILITY

Strengthening the cohesion of the nation will rely on consolidating the legitimacy, relevance and authority of the National Government. The relevance of the National Government to the people depends on how well the Government is active and contributes to their well being by delivering basic services.

While there will be opportunities for specific interventions to promote peace and stability, the most effective on-going response of the aid program to issues of instability is to support stronger broad-based growth, improved service delivery and more effective governance (that is, to strengthen the capacity of the state to meet the needs and aspirations of the people).

IMPLEMENTATION OF THE AID PROGRAM

The fundamental questions confronting the aid program over the next five to ten years are why PNG's economic and social progress has been so disappointing, why governance remains weak, and whether Australian aid can provide more effective support for stronger outcomes.

SIZE AND REACH OF THE PROGRAM

Arguably, the breadth of the aid program, with its reach into nearly all sectors of activity, has undermined rather than underpinned improvement in some respects. In some sectors, and some parts of the country, the availability of aid interventions has encouraged the substitution of aid for the use of PNG's own resources, allowing the latter to be diverted to other, often lower priority, uses. The breadth of the program may also have contributed to a failure to leverage stronger overall performance by the Government of PNG. The flexibility of

the program (which, in part reflects its size), and a genuine and well-intentioned willingness to respond to emerging issues of need, has generated expectations among some groups in PNG that aid resources are available if representations are made. Australia is not responsible for service delivery, or particular outcomes in PNG. The only effective and sustainable contribution of the aid program is to complement and support the work of the PNG Government in meeting its responsibilities and objectives, not to supplant it.

A clearer focus for the Australian aid program (and in this context 'clearer' means 'narrower'), coupled with firm governance arrangements, would require more focused commitment by the PNG Government, and should facilitate the stronger involvement of other donors who may be better placed to deal with particular aspects of the challenges associated with promoting growth.

A COMPACT

Going forward, an essential feature of the aid relationship must be that aid works effectively with PNG's own resources and support agreed objectives and priorities. A carefully constructed compact which clarifies the role the aid program is to play in supporting PNG efforts—and the responsibilities which the Government will meet through its own efforts—would provide much needed clarity.

GOOD ENOUGH

The aid program needs to reflect good enough principles in its design, implementation and expectations. Arguably the program in the past has been too ambitious, too broad and sought to progress too many objectives without regard to sequencing to support the most important priorities.

CENTRAL AGENCY ENGAGEMENT

PNG cannot effectively address its challenges without the central machinery of government driving a coherent and affordable agenda. The design of the Enhanced Cooperation Program (ECP) recognised the importance of central agencies and

the machinery of government. While the immediate outlook for ECP is unclear, the aid program must continue to engage with central agencies as an essential ingredient to improved performance

MODALITIES

Consistency is important in selecting modalities—the way aid interventions are designed and implemented. Frequent change creates confusion and uncertainty. The reasons for and benefits of change may not be embraced as quickly within PNG as within Australia.

IMPLICATIONS FOR THE AID PROGRAM: DRAWING THESE TOGETHER

Three fundamental conclusions should inform the future direction and positioning of the aid program over the medium term:

1. PNG must generate stronger economic growth
2. service delivery needs to be improved
3. governance must be strengthened.

Growth at nearly double the rates currently projected in the PNG Budget for the coming years is needed if poverty is to be reduced. Growth needs to be broad-based to maximise the impact on the lives of people across the country and to strengthen the Government's fiscal capacity to contribute effectively to the economic and social advancement of Papua New Guineans. Carefully prioritised programs and consistency of implementation are also required. Overcoming constraints to growth is the key. The aid program must support growth if the PNG Government's capacity to deliver improved services is to be strengthened.

Governments at all levels in PNG must work to improve service delivery. This requires a stronger fiscal position overall, greater equity in access to funding for service delivery, more effective operation of the decentralised service delivery framework, identification of priorities, and stronger and more consistent commitment.

Improving the enabling environment, strengthening governance and generating stronger growth are interdependent.

PNG faces huge challenges and costs in providing services, but more could be done with available resources. The inefficient, ineffective and inconsistent use of existing resources is preventing better outcomes.

SUPPORTING STRONGER BROAD-BASED GROWTH

A strong focus is required to address the binding constraints that have inhibited PNG's growth performance. Priorities should be:

- > A stronger focus on infrastructure. This is consistent with PNG's own priorities as set down in the MTDS, but greater clarity is needed on the contributions of donors and PNG, including for infrastructure maintenance.
- > Other binding constraints. A manageable and carefully prioritised program of sequenced initiatives is needed to address those constraints which impede growth and development. This can only be achieved with the full cooperation of, and within the limits of, all parties. A joint technical economic team, with representatives from PNG, Australia and possibly other donors such as the World Bank, could conduct a critical path analysis outlining what is required to address constraints to growth, consistent with MTDS objectives. Genuine partnership and PNG Government commitment to implement the outcomes of such a critical path analysis would be essential.

In supporting growth, the aid program must work in concert with other donors and draw on the comparative advantage of different donors, particularly the development banks. Critically, it must work in concert with the Government of PNG and its use of its own resources. Clear priorities and expectations need to be established, supported by consistent implementation.

Supporting PNG's efforts to improve service delivery to the most vulnerable, but with reduced exposure to, and involvement in, service delivery generally

A stronger focus on supporting growth will require reduced and more focused support for service delivery. This implies that PNG must accept greater responsibility for service delivery generally. Priorities will need to be agreed and implementation

monitored. Consistency and long-term support are required.

WORKING STRATEGICALLY TO IMPROVE GOVERNANCE

Interventions should recognise and reflect the practical reality of good enough governance. This means identifying key priorities and focussing on practical issues, particularly strengthening the machinery of government.

The arrangements and functional responsibilities under the 1995 Organic Law on Provincial and Local Level Government need to be re-examined. The current decentralisation framework has contributed substantially to deterioration in service delivery, lack of transparency and accountability, and weak performance.

A COMPACT

There is a need for greater rigour in monitoring and evaluating aid effectiveness. This should be important to both governments. A compact which sets out agreed priorities and mutual commitments and expectations of both governments would provide a framework for consultation, monitoring and evaluation. This would be effective in ensuring that the Country Strategy, when finalised, was appropriately operationalised.

CONSISTENCY AND PATIENCE

Australia's commitment to long-term engagement with PNG must come with consistency and patience. There are no quick fixes. Frequently changing priorities undermines confidence and generates confusion. This in turn weakens prospects for positive outcomes. Unrealistic expectations similarly generate counter-productive frustrations.

1 Development overview, outlook and context

SNAPSHOT OF DEVELOPMENT PROGRESS AND MEDIUM-TERM OUTLOOK

OVERVIEW

PNG faces enormous development challenges. It has a vibrant although volatile democracy and the task of building nationhood, particularly given the extremely fragmented nature of PNG society, remains complex and challenging.

Despite recent economic relief from strong commodity prices the country continues to face difficult economic circumstances. There is widespread breakdown in service delivery and the economic and social impact of the emerging HIV/AIDS crisis will intensify in the next three to five years. There are cases of instability, particularly in the Highlands, and crime is increasing. The population will double in the next 20 years. These factors place a premium on generating sustainable broad based growth and employment, which PNG has struggled to achieve.

CURRENT ECONOMIC SITUATION

Modest economic growth returned to PNG in 2003 after a sustained period of contraction (1996–2002), in part buoyed by favourable weather conditions and

good prices for the country's main exports. However, per capita income in 2003 was less than it was in 1975.¹ Formal employment grew by only 1.5 per cent over the period 1996–2003.²

The 2005 National Budget projects growth to continue over the next five years, with non-mining real GDP growth forecast to grow by 2.8 per cent in 2005 and from three to 3.5 per cent over the period 2006–2009. With the projected rapidly increasing population, economic growth of around three per cent will be insufficient to yield significant increases in per capita incomes over the medium term.

The PNG Government has made progress on the public finance front. Fiscal consolidation is being achieved, and a potential descent into debt unsustainability averted. There are encouraging signs of macroeconomic stability, including prudent monetary policy, improved budgetary performance, lower interest rates, appreciation in the exchange rate, and increasing international reserves. There was a small fiscal surplus of around one per cent of GDP in 2004.³ The Budget forecast for 2005 states that with continuing tight fiscal management, a small fiscal deficit of one per cent of GDP will be achieved. Tight fiscal management is projected to maintain small deficits and surpluses (between -0.6% to +0.3% of GDP) over the period 2006–2009.⁴

1 World Bank, Papua New Guinea: Interim Strategy Note, (April 2005).

2 Asian Development Bank, Country Strategy and Program Update 2004–2006 (January 2004)

3 PNG 2005 Budget Papers – Volume 1 – Economic and Development Policies, Table A3.10

4 Ibid.

Table 1: Papua New Guinea—recent economic performance (selected indicators)⁵

	1999	2000	2001	2002	2003
Income and Growth					
GDP per capita (US\$, current prices)	686	664	553	512	566
GDP Growth (% , constant prices)	7.6	(1.2)	(2.3)	(0.8)	2.0
Saving & Investment (% of GDP)					
Gross Domestic Investment	16.4	13.0			
Gross Domestic Saving	13.3	25.3			
Inflation					
Consumer Price Index (annual %)	14.9	15.6	9.3	11.8	11.8
Government Finance (% of GDP)					
Total Revenue & Grants	29.3	31.6	32.0	29.4	31.7
Total Expenditure & Onlending	31.9	33.6	35.6	33.4	33.4
Fiscal balance (surplus(+), deficit (-))	(2.6)	(2.0)	(3.6)	(4.1)	(1.7)
Balance of Payments (% of GDP)					
Merchandise Trade Balance	25.6	31.9	29.2	19.9	33.0
Current Account Balance	4.2	10.2	9.5	(4.6)	9.1
External Payments Indicators					
Gross Official Reserves (months of imports)	2.4	4.0	6.1	4.2	4.9
External Debt Service (% of exports)	7.5	6.7	7.1	7.4	8.3
External Debt (% of GDP)	43.4	40.3	50.1		

Table 2: Papua New Guinea—selected social and development indicators.⁶

	1970–75	1980–85	1997–2003
Population			
Population (millions)	2.7	3.5	5.5
Population growth rate (%)	2.4	2.6	2.4
Urban population (% of total population)	11.9	13.1	13.2
Poverty			
Number of poor (millions) 1996 and 2005	-	-	1.1 – 2.3
(using international poverty line—US\$1 per day)			
Public expenditure (% of GDP)			
Health	-	-	3.9
Education	4.4	-	2.3
Life expectancy at birth (years)	49	53	57
Total fertility rate (births per woman)			
Infant mortality (per 1,000 live births)	90	79	70
Illiteracy (% of population 15+ years)	-	-	35
Access to improved water source (% of pop.)	-	-	42
Human development index rank (175 countries)	-	-	132

5 Source: Ibid (Appendix1)

6 World Bank, Papua New Guinea: Interim Strategy Note - Annexes (April 2005).

PNG's fiscal outlook will remain constrained for the foreseeable future. High spending on public service wages and salaries (including for ghost employees), debt-service obligations, low productivity, and a possible relaxation of fiscal discipline ahead of the 2007 national election will present on-going political and managerial challenges over the coming years. It is a scenario in which funds available for spending on delivery of goods and services are likely to diminish beyond current levels—levels already inadequate to meet the reasonable needs of the population.

SOCIAL AND HUMAN DEVELOPMENT

Despite substantial improvements since Independence in some key social indicators,⁷ overall PNG has the worst social indicators in the Pacific⁸ and its human development indicators remain poor relative to its per capita income. PNG will not achieve the Millenium Development Goals (MDG) by 2015.

THE HIV/AIDS DIMENSION

The longer term effects of an emerging HIV/AIDS epidemic in PNG could be immense. HIV prevalence in PNG is now approaching two per cent of the adult population.⁸ A 2002 report by the Australian Centre for International Economics (CIE)⁹ found that if the emerging crisis is not addressed, under a worst case scenario, deaths from HIV/AIDS could reach over 120,000 per year and the workforce could be reduced by 34 per cent by 2020.

As the epidemic progresses it strains education systems, weakens demand, widens the gender gap, and potentially leads to increased costs across all sectors of the economy.^{11,12} AusAID's draft HIV/AIDS thematic report states: 'Of most significance to Australia in the next five to ten years

is the escalating impact of a generalised epidemic in PNG...Already PNG is losing at least one teacher a week from the workforce due to HIV/AIDS related illness and deaths.'¹³

It seems clear that Australia will need to play a significant role in helping PNG address its emerging HIV/AIDS epidemic, and *Australia's International HIV/AIDS Strategy* (AusAID 2004) commits AusAID to mainstreaming HIV/AIDS across its development cooperation activities. AusAID's draft HIV/AIDS thematic report concludes that an immediate priority should be accorded to elevating the breadth and depth of the response to HIV/AIDS in PNG.¹⁴ However, in PNG, national and provincial AIDS councils have been under-resourced and unable to operate effectively. National government leadership has been mixed on HIV/AIDs and there is need for much stronger coordination among the agencies involved, including donors and NGOs. And for mainstreaming to work, finance and planning ministries that control budgets and negotiate the terms of foreign assistance must have HIV/AIDS as a clear priority.¹⁵

OUTLOOK

Despite recent positive signs, PNG's medium-term economic outlook is uncertain. The current economic recovery is fragile, and significant impediments to higher levels of sustainable growth remain.

The country faces many endogenous structural and policy issues which inhibit prospects for higher levels of sustainable growth. These include law and order problems, political instability, inadequate and poorly maintained physical infrastructure (particularly transport infrastructure), uncertainty over property rights, limited access to credit, and a limited human capital base (reflecting poor health

7 AusAID (2003) 'The Contribution of Australian Aid to Papua New Guinea's Development 1975-2000', p ix

8 Ibid.

9 A 2004 PNG Consensus meeting that reviewed surveillance data estimated prevalence at 1.7% of the adult population.

10 Centre for International Economics "HIV/AIDS in Papua New Guinea" (2002).

11 AIDS patients already regularly occupy more than 50 per cent of medical ward beds at Port Moresby General Hospital.

12 AusAID Issues Paper: HIV/AIDS in the Asia Pacific Region – draft of 19 July 2005.

13 Ibid.

14 Ibid, page 32.

15 Ibid

and education standards). There is strong evidence that the overvaluation of kina between 1975 and the early 1990s had a substantial depressant effect on the development of the agricultural sector.

PNG's small, relatively open, formal economy depends on a limited number of primary commodities and is vulnerable to exogenous shocks. The dominance of a few commodities with fluctuating prices leaves its economic prospects vulnerable to significant year-to-year variation in export earnings with consequential implications for exchange rate movements and inflation. The contribution of the extractive resource sector to growth is projected to decline in the years ahead.

Poor economic performance is reflected in increasing poverty levels. While it is difficult to determine poverty levels with confidence, on the basis of the national poverty line,¹⁶ the proportion of poor is estimated to have increased from 37.5 per cent of the population in 1996 to about 54 per cent in 2003.¹⁷ In terms of international measures of poverty (US\$1/day), poverty is estimated to have risen from about 25 per cent of the population to just under 40 per cent over from 1996 to 2003.¹⁸ While these measures may overstate the extent of poverty, and while recent economic recovery should result in some turnaround in these indicators, it is clear that developing broader sources of growth, particularly in rural areas where the majority of the poor live, must be a priority if PNG is to make real gains in addressing its poverty problems.

PAPUA NEW GUINEA'S MEDIUM-TERM DEVELOPMENT STRATEGY AND NATIONAL POVERTY REDUCTION STRATEGY¹⁹

The Medium-Term Development Strategy (MTDS) (2005–2010) is the main planning document of the PNG Government. It adopts a theme to reduce

poverty through rural development. MTDS objectives are to be reflected in the National Poverty Reduction Strategy (NPRS), but this however, has not been completed or endorsed.

Assessments of poverty reducing strategies and delivery mechanisms conclude that poverty results from: weak governance; weak social support systems; inefficient use of natural resources; lack of economic and financial growth opportunities; a poorly maintained infrastructure network; and the inefficient delivery of, and lack of access to, basic services. The framework of the Government's NPRS is expected to involve the MTDS's expenditure priorities:

1. basic education
2. primary health
3. transport infrastructure and maintenance
4. law and order
5. income-generating opportunities (especially in rural areas).

CURRENT AID PROGRAM

The current Australian aid program comprises A\$300 million per annum in country programmed aid to PNG. Other aid totals an additional A\$192.3 million for financial year 2005–06. The aid program's coverage is extensive with engagement in all five priority areas of the MTDS:

- > The key priorities for the A\$300 million of country programmed aid include: fostering sustainable development (transport infrastructure and renewable resources); building stronger governance; developing institutional capacity (governance, law and order, health and education), and addressing HIV/AIDS.
- > A major proportion of the estimated additional A\$192.3 million is for the ECP which focuses

16 The national poverty line corresponds to a nutritional norm of 2,200 calories per adult equivalent and also allows for basic non-food expenditure. . The most recent household survey data on which such poverty measurement can be directly based are from the National Household Survey of 1996. . No nationally representative survey of income or consumption has been undertaken.

17 World Bank, *op cit*

18 *Ibid*

18 In May 2005 a Supreme Court of PNG decision found elements of the ECP program were inconsistent with PNG's Constitution.. The decision has required the policing element of the ECP program being suspended indefinitely while the future of the entire ECP program is currently being reconsidered in consultation with the PNG Government

19 Source: ADB website: <http://www.adb.org/Documents/IndigenousPeoples/png/SIPSA-r35-04-PNG.pdf>

on weaknesses in administrative capacity, re-establishing investor confidence and providing an enabling environment for broad-based development. The program includes initiatives in policing, law and justice, economic and public sector management, and border and transport security. The cost of the ECP program is estimated at A\$1.1 billion over a five-year period, A\$300 million of which is to be provided out of the existing bilateral aid program. At present, the policing component of ECP has been withdrawn, and the immediate outlook for the remainder of the program is uncertain.

LESSONS LEARNT FROM PAST ENGAGEMENT

AusAID's experience working with PNG has highlighted key lessons on what is required for successful aid engagement, including:

- > the importance of local ownership, leadership and early participation of all parties
- > clearly understood expectations from the outset
- > recognition of comparative advantages
- > flexibility to deal with changing country conditions
- > the importance of backing genuine reformers in their efforts to strengthen existing institutions
- > facilitating a broadly shared understanding of what constitutes an appropriately sequenced reform agenda for public expenditure management
- > working with national and provincial government levels, to promote better communication and coordination across government
- > the need to focus aid program resources so they leverage the greatest benefits from PNG's use of its own resources in areas of greatest priority
- > the need to work in support of partner government systems and policies to produce more sustainable improvements in institutional capacity and service delivery
- > the need for patience, particularly on the part of donors, in waiting for successful outcomes

- > taking a sector-wide approach where feasible to foster donor coordination and allow national departments to demonstrate and develop leadership and organisational capacities
- > combating corruption, which undermines the effectiveness and impact of aid interventions, however well conceived these might be
- > the need for robust analysis and evaluation of the appropriateness and effectiveness of aid interventions.

ROLE AND FUTURE DIRECTION OF THE WORLD BANK, THE ASIAN DEVELOPMENT BANK AND OTHER AGENCY ENGAGEMENT

THE WORLD BANK AND THE ASIAN DEVELOPMENT BANK

In 2002 Australia, the Asian Development Bank (ADB) and the World Bank recognised that the immense development challenges facing PNG called for a different approach from donors and they agreed to work more closely together under the umbrella of a Joint Country Strategy (JCS). The JCS aims to more closely align donor support around PNG's development priorities through joint analytical and advisory services, policy dialogue, and coordinated financing of high-priority investments. By the end of 2003 the PNG Government had disengaged from the development of the JCS as it came to the view that the JCS was an attempt by donors to 'gang up' on the country. PNG's Government also believed it had not been consulted in the JCS process early enough. In addition, by this time the new ECP was complicating the nature of Australia's aid engagement with PNG's Government and other donors. Despite this all donors remain strongly committed to developing a joint approach to aid delivery.

The **World Bank** has indicated its priorities for working with PNG are to help the country realise its growth and poverty reduction potential through better governance, sound economic management, and sustainable natural resource exploitation, while ensuring that the spread of HIV/AIDS is contained.²⁰

²⁰ World Bank, *op cit*

The Bank's Interim Strategy will focus its efforts on: promoting development dialogue and mitigating the decline in social indicators by deepening the relationship with government at all levels; reaching out to stakeholders in broader society, and enhancing coordination with other development partners; and building the foundations for improved governance and sustained recovery through analytical work, selective capacity building and targeted priority investments in basic services.

The **ADB** strategy for PNG (2004–2006)²¹ focuses on strengthening governance, supporting private-sector development and improving social conditions. The ADB is strengthening public sector management, particularly in the areas of fiscal and financial management and public service reform. For private sector development, ADB is helping to improve sector policy and institutional frameworks (agriculture and fisheries), enhance factor productivity (skills development and microfinance services) and improve market access by selected transport infrastructure investments, especially in rural areas. In the social sectors, ADB will continue to assist in policy development (health) and to support infrastructure investments (water and sanitation) and service delivery.

The potential scope for engagement by the World Bank and ADB is substantial. However, recent decisions by both institutions to scale back their level of engagement following unresolved issues with PNG authorities has resulted in limited operational engagement at present.

JAPANESE AID TO PNG

Japan is the second largest bilateral donor to PNG. The focus of Japan's aid efforts are in transportation and communication, health, education, agriculture, environment, and other areas such as law and order. Japan's Official Development Assistance (ODA) to PNG is delivered through grant aid, concessional loans and technical cooperation assistance provided by Japan's Department of Foreign Affairs, the Japanese Bank for International Cooperation (JBIC)

and the Japan International Cooperation Agency (JICA).

Potential areas for joint cooperation include supporting the PNG health sector. JBIC has also suggested better donor coordination, especially regarding the Highlands Highway bridges. Post-conflict is a policy focus for Japanese aid and Japan is interested in discussing the post-conflict province of Bougainville with Australia.

EUROPEAN UNION AID TO PNG

The European Union (EU) is the third largest donor to PNG. The focus of EU aid efforts are in education, training and human resource development, rural water supply and sanitation, and institutional capacity building and governance. EU Official Development Assistance to PNG is delivered through its Country Strategy and National Indicative Program (NIP) 2002–2007. Potential areas for cooperation with Australia include the areas of education, HIV/AIDS, transport and coordination to build capacity of local NGOs, and use other non-state actors to deliver essential services.

²¹ Asian Development Bank, *op cit*. The ADB also considers its current strategy should be viewed as an interim strategy in lieu of development of a joint Country Strategy with the World Bank and AusAID.

2 Emerging and critical issues

POSITIONING THE AID PROGRAM IN THE BROADER AUSTRALIA-PNG BILATERAL RELATIONSHIP

The objective of Australia's aid program is 'to advance Australia's national interest by helping developing countries reduce poverty and achieve sustainable development.'²² The purpose of this report is to consider how the aid program to PNG might be positioned over the next five to ten years to give stronger effect to this objective in the light of past experience and likely developments. It does this by addressing the role of the aid program in supporting the key issues of economic growth, political governance and stability. To do so the report outlines how Australia's national interest is to be understood in the PNG context.

There is no specific formal enunciation of Australia's broader foreign policy goals for its relationship with PNG, but Australia's national interests have been well documented in *Advancing the National Interest*²³ statement which observes that 'among the island countries of the South Pacific, Australia's strategic, economic and consular interests are greatest in PNG...PNG will look to Australia to help keep poverty and lawlessness in check. The onus for meeting these challenges will lie with independent PNG: Australia can—and will—play a supportive role. Australia will continue to encourage sustainable

economic and political reform and the strengthening of basic services. The [Australian] Government supports close engagement between PNG and the International Monetary Fund and multilateral development banks. Australia will also help PNG to build affordable, capable and loyal security services and to strengthen its border security, including in the Torres Strait area. The statement also notes that 'both countries will have to work hard and with goodwill if this unique and complex relationship is to continue to deepen and mature.'

The recent Australian Strategic Policy Institute (ASPI) report—*Strengthening Our Neighbour*²⁴—observed that Australia's national interest considerations range from geo-strategic concerns relating to Australia's defence, to more immediate concerns with the possible impacts on Australia of transnational threats such as cross-border crime, international terrorism, disease pandemics, and people movement.

National interest considerations dictate that Australia has a significant stake in a policy of enlightened self-interest towards PNG that combines these specific concerns with wider humanitarian interests and a shared history as the ex-colonial administrator and the largest nation in the South Pacific region. In essence, Australia has a strong economic and

22 *Australian Aid: Investing in Growth, Stability and Prosperity*. Eleventh Ministerial Statement to Parliament on Australia's Development Cooperation Program (September 2002)

23 Foreign Affairs and Trade White Paper: *Advancing the National Interest*, 12th February 2003.

24 Australian Strategic Policy Institute: *Strengthening Our Neighbour—Australia and the future of Papua New Guinea*, December 2004.

strategic self-interest in supporting PNG to deal more effectively with the challenges it faces.

PNG is of significant commercial interest to Australia. Two-way trade is valued at about A\$2 billion annually, making it Australia's twenty-second largest trading partner.²⁵ The mining sector has traditionally been a focus of Australian investment interest in the country, with most larger Australian based mining companies involved in a number of projects, including gold mining and oil/gas.

Consideration of Australia's broader national interests would reasonably be expected to include seeing PNG develop as a stable and peaceful nation, with an economy generating real growth, and improving social and human development indicators pointing to an enhanced quality of life for Papua New Guineans across the country.

Historically the relationship between Australia and PNG has been strong in some areas, stemming particularly from our colonial and historic ties. The relationship has included strong business links, close defence cooperation, and particularly, close people-to-people links. But the relationship has become more fragile in recent times. With the passage of time, the strong people-to-people links that underpinned the relationship in subtle, but important, ways are fading. Over recent years aid has come to dominate and define the relationship.

The aid relationship between Australia and PNG is enshrined in the *Treaty on Development Cooperation* (TDC) signed by the two nations in 2000.²⁶ The TDC, in turn is based on the Joint Declaration of Principles Guiding Relations between Australia and PNG signed on 9 December 1987. The ECP is based on a Joint Agreement on Enhanced Cooperation signed on 30 June 2004. The TDC provides for the large part of the aid program to be developed as jointly programmed aid. It establishes the framework for providing Australian aid to PNG, including how priorities are to be determined and performance assessed. It also establishes the framework within which Australia is to determine the quantum of aid to PNG in a given year.

Notwithstanding regular high-level consultations between Australia and PNG at both official and ministerial levels, the generally weakening links between the two countries and the changes in the priorities and perspectives of both countries, associated with weak or inconsistent observance of some of the key provisions of the Treaty, have given rise to uncertainty and confusion about the aid program and, to some extent, increasing frustration and dissatisfaction on both sides. The 2004 Joint Aid Review²⁷ made recommendations on strengthening effective engagement between the two countries in relation to the aid program.

The events of the past 12 months or so, particularly associated with the ECP, make reconsidering key aspects of the aid program to PNG timely. Recent initiatives by the Australian Government make clear its concerns that PNG is not making reasonable progress in a number of areas, while for its part the PNG Government has voiced concerns that Australia is adopting an increasingly unilateral approach in its dealings with the country. These developments raise important questions about the relationship between the two countries and the future direction of the aid program.

What is needed now is not just another aid review. Clear directions, priorities and modalities for the aid program going forward need to be established which reflect the interests, objectives and aspirations of both countries, and to which both are committed. It is significant that the majority of Papua New Guineans, particularly those in rural and remote locations, strongly support the Australian aid program and, more generally, calls for change are neither dramatic nor widespread. (It is also significant that some senior PNG leaders are now articulating the need for a different aid relationship with Australia, including a path away from aid dependency). So far as the aid program is concerned, the over-riding requirement is to establish and implement cooperative processes to allow jointly agreed objectives and priorities to be determined, performance expectations to be set and monitored,

25 Australian Government, Department of Foreign Affairs and Trade - Papua New Guinea Country Brief (April 2005).

26 The current TDC replaces an earlier TDC signed on 24 May 1989. . The earlier TDC facilitated the evolution of the development cooperation program from a budget support basis to a jointly programmed aid basis over a ten-year period.

27 Joint Review of the Australian Aid Program to Papua New Guinea, Final Report, 31 August 2004

and ways to work consistently, cooperatively and effectively to be consolidated.

For Australia's part, realistic expectations are needed. PNG is still a young country with limited resources, fledgling institutions and fragile governance. Its capacity to determine the directions it wishes to take, and to implement the policies and programs needed for sustained growth, is limited. Australia's aid, while a significant boost to available resources, is still only about 17 per cent of the budget envelope (excluding ECP). Achieving improvements in areas of economic growth, service delivery and in improved governance will take time. Critically, it will require a consistent and constructive relationship with Australia in which the aid program will play an important part.

For PNG's part, stronger performance has to be achieved. Poverty is increasing, service delivery networks are failing and opportunities have been lost. The development of a sound and affordable policy framework is required, supported by a stronger and consistent commitment to growth, better governance and effective and equitable service delivery to people across the country. A consistent long-term approach is needed, with PNG's Government working in concert with development partners to implement a coherent and affordable agenda.

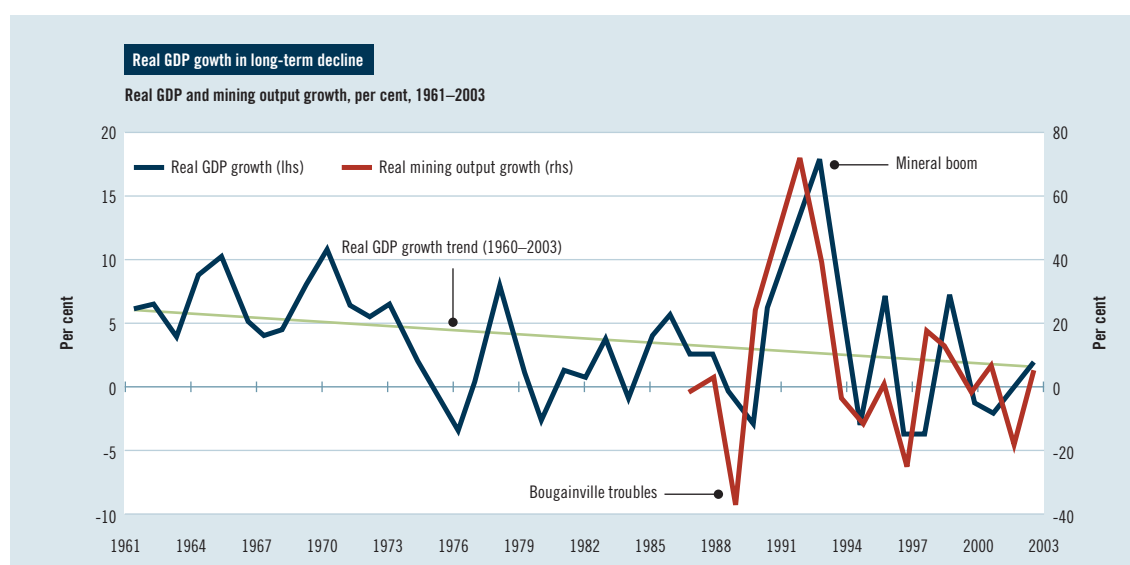
GROWTH

RECENT GROWTH PERFORMANCE

The last ten years have seen rising poverty in PNG, with estimates suggesting that 2.3 million Papua New Guineans are now living on less than US\$1 per day, up from 1.1 million in 1996.²⁸ The country's growth record over the last 20 years has been well documented. While growth year-to-year has been volatile (Figure 1) trend growth slowed from around six per cent per annum in 1960 to around two per cent in 2002.²⁹ From 1991 to 1994 the economy grew rapidly, largely due to the performance of the petroleum and mining sectors. Between 1995 and 2002 the economy contracted in all but two years. High inflation and rapid population growth mean that per capita incomes fell an estimated 18 per cent between 1994 and 2002. In US\$ terms per capita income in 2003, at US\$510, was substantially less than it was in 1975 (US\$560).³⁰

PNG's economic growth performance compares unfavourably with other developing and emerging market economies. For example, in the Pacific region, real per capita GDP increased in Samoa more than 50 per cent over the same period, while growth in Fiji was some 30 per cent.

Figure 1: Papua New Guinea—long-term growth performance³¹



28 World Bank, Papua New Guinea: Interim Strategy Note, 2005.

29 DFAT Economic Analytical Unit (EAU), *Papua New Guinea—The Road Ahead*, Figure 1.1, (Australian Government, 2004)

30 World Bank, *op cit*.

31 DFAT EAU report, *op cit* – Figure 1.1

THE SOCIAL AND HUMAN DEVELOPMENT DIMENSION

Despite improvements since Independence in some key social indicators,³² overall PNG has the worst social indicators in the Pacific.³³ It has lower average life expectancy, a higher infant mortality rate and lower rates of adult literacy than most countries in the region. Women are particularly disadvantaged with lower life expectancy, significantly lower participation in the education system and high rates of maternal mortality. PNG is ranked 132 out of 175 countries by the 2003 United Nations Human Development Report Human Development Index and has the highest poverty index among the 12 Pacific countries.³⁴ PNG has remained in the bottom 25 per cent on the Human Development Index ranking over the past 25 years.

On the basis of its economic and social indicators, as well as indicators of institutional quality, PNG has been included by the World Bank as a non-core member of 26 countries categorised as low income country under stress (LICUS), also commonly referred to as fragile states. Other core LICUS countries (15 in total) include East Timor, Lao PDR, Cambodia, and Nigeria.³⁵

PNG has a young population and one of the highest rates of population growth in the Pacific region. Its population has almost doubled, from 2.9 million at Independence, to 5.5 million (2003), growing at an average rate of around 2.7 per cent per year. Forty one per cent of the population is under the age of 15. The country's rapidly growing population is adding significantly to the burden of delivering essential social services. On current trends, the population is projected to double again over the next 20 years, by which time it will be approaching half the total population of Australia. However, depending on how it develops, the emerging HIV/AIDS epidemic in PNG could have a substantial impact on population growth over this period.

THE VILLAGE MAJORITY

Eighty five per cent of the PNG population live in rural areas. The rural population grows almost all its own food and uses money from the sale of cash crops to meet some proportion of education and health care costs. This constitutes an important source of stability to the nation and a form of employment to a large number of the work force, including, importantly, young men.

It is important to the overall stability of PNG to recognise the on-going importance of village agriculture, and to ensure that the aid program does not undermine its role by inflating expectations which are illusory. It is clear that, even on the most favourable assumptions about growth, village agriculture will continue to sustain the overwhelming majority of Papua New Guineans for the foreseeable future.

Supporting the development and maintenance of infrastructure to support access to markets and to essential services is an area in which the aid program can contribute to strengthening village agriculture. Beyond that, Australian support in the areas of research and building up technical skills would be appropriate, and the contribution of village agriculture would be strengthened with improved governance and security generally. Consistent and equitable access to basic education and health services will also contribute to improving the quality of life in rural areas and enhancing the attractiveness of village life.

PROSPECTS FOR GROWTH

Projections of future growth rates vary, as do views about PNG's growth prospects generally. The PNG departments of Treasury and National Planning have differing projections for growth, ranging from 2.5 to 5 per cent per annum over the next few years. With population currently growing by around 2.7 per cent per annum, even growth at the higher end

32 AusAID (2003) 'The Contribution of Australian Aid to Papua New Guinea's Development 1975-2000', p ix

33 World Bank, op cit.

34 WorldBank: www.worldbank.org/INTPAPUANEWGUINEA/Resources/11-Country-Context-Development-Trends.pdf

35 *Evaluation of World Bank Support to LICUS – An Approach Paper*, World Bank (2005).- Table 1. . For FY05 26 countries are defined as LICUS – 11 of them are categorised as "severe" LICUS and the remaining 15 countries are categorised as core LICUS

of this range will not generate meaningful increases in real per capita incomes, let alone redress the loss of income over the 1990s. Even at the upper end, the growth forecasts are well below the six to seven per cent per annum which the IMF and World Bank consider necessary to make significant inroads into reducing poverty.

Spikes in growth have been due largely to the oil and mining sector. But in the extractive resource sector many projects are phasing out. Although there are some prospects from new projects, such as the gas pipeline to Australia, the medium-term trend for the extractive sector is not promising. The 2005 PNG National Budget projects that the contribution to real GDP growth from mining and oil over the next few years will vary from -0.9 per cent in 2006 to +0.6 per cent in 2009. In net terms the contribution of this important sector to real GDP growth is projected to diminish between 2005 and 2009. Beyond that time frame, the gas project, in particular, could contribute to offset this trend.

It is difficult to be optimistic, or even confident, about the level of growth that might be achieved over the next five to ten years, particularly the prospects for more broadly-based growth.

Some commentators have argued there is no natural resource constraint to sustainable real growth of around six to seven per cent per annum. They point to PNG's abundant fertile soils in which a wide variety of marketable crops can be grown, the considerable scope for agricultural productivity gains (which include a large land mass, huge factor endowments particularly in forestry asset, mineral deposits, and tuna stocks), and a large population base.

The 2005 National Budget projects around half of total GDP growth will come from the agricultural, forestry and fisheries sector between 2005–2009. While it provides the most substantial contribution to PNG's GDP and economic growth, the contribution of this sector will need to be substantially increased

if higher overall levels of growth are to be achieved. Given the lack of growth in the economy overall over the past two decades, the very small increase in the GDP share of this sector is of concern.

The Government's MTDS 2005–2010 recognises the importance of targeting rural development as a key to achieving higher levels of economic growth and poverty reduction. However, clearly defined strategies for growth, backed by the consistent implementation of priorities to generate it, are required if this potential is to be fulfilled. The lack of strong and consistent linkages between the last MTDS and the annual budgets undermined the effectiveness of the MTDS process. At this time, and notwithstanding the emphasis given to growth in the MTDS, specific strategies, assurance of funding and commitment to implementation are inadequately developed.

It is significant that PNG's own budget projections³⁶ show that central government revenue and grants as a percentage of GDP will peak in 2005 and then decline to 2009. While recurrent spending is also projected to decline to 2009 (17.6 per cent compared with 19.9 per cent in 2005), the proportion of recurrent expenditure accounted for by interest on debt and wages, at 64 per cent of the total (projection for 2009), is significantly greater than in 2002 (59 per cent). Other budget analysis³⁷ suggests that spending adjustments of up to 1.9 per cent of GDP will be needed over this period to keep deficits manageable. Warner finds that if expenditure constraints fall on spending on goods and services, rather than wages, real operations and maintenance will have to fall by 45 per cent over 2004 levels.³⁸ The clear implication of these projections is that PNG's capacity to improve standards of service delivery across the country over the next five years is expected to decline, rather than strengthen. The importance of stronger, broad-based growth which enhances the Government's fiscal capacity is clear.

36 PNG 2005 Budget Papers, Volume 1 Economic and Development Indicators.

37 Warner, Bob: in Pursuing Broad Based Growth in Papua New Guinea, non-published paper for AusAID, May 2005.

38 Ibid

CONSTRAINTS TO GROWTH

If PNG is to achieve the growth rate of six to seven per cent per annum over the medium term needed to redress the loss in per capita income since Independence, growth will need to be broad-based and sustainable. Generating sustained broad-based growth cannot be achieved without a focus on overcoming the constraints which currently hinder wider growth opportunities.

Commentators have drawn attention to a range of constraints to growth in the current PNG environment.³⁹ These have included:

- > law and order issues
- > infrastructure weaknesses which isolate people and their produce from markets
- > corruption
- > policy uncertainty
- > investment and regulatory weaknesses and a poor governance environment for business
- > inadequate human capital (skills, education levels, worker productivity, and health issues)
- > poor social capital—a weak sense of national identity and national interest
- > lack of financial market depth and poor access to funds for investment purposes (although there is evidence that it is the lack of productive opportunities rather than a shortage of capital that is the real constraint)
- > constitutional impediments associated with the Organic Law on Provincial and Local Level Government
- > property rights, including land tenure issues
- > fragmentation
- > lack of competitiveness.

To put these issues in perspective, the Department of Foreign Affairs and Trade EAU Report (see references) notes that PNG ranks poorly under the 2002 World Bank Governance Indicators Index. In terms of political stability, rule of law, government effectiveness, and control of corruption, PNG ranked below all other groups of countries, including Latin America, East Asia and sub-Saharan Africa.

These constraints to growth clearly need to be tackled aggressively if PNG is to achieve adequate rates of broad-based growth. But not everything can be achieved at once. Capacity constraints and absorptive capacity issues limit what can be realistically achieved. It is easy to overwhelm weak systems. Attention needs to be given to dealing with key or binding constraints, with reforms focused where their direct effects can be reasonably expected to generate the most significant benefits.

For PNG, binding constraints appear to be fundamentally related to issues of policy settings, identification of key priorities, consistent implementation of relevant and affordable programs, and governance. These include:

- > getting the key economic policy settings and priorities right—and consistent adherence to an affordable and coherent agenda
- > addressing infrastructure weaknesses, particularly roads, with an affordable and prioritised program for infrastructure development
- > removing impediments and disincentives to investment
- > addressing law and order issues (particularly for small businesses) and establishing an acceptable security environment for broad-based growth
- > establishing a supportive framework for business through secure property rights, less burdensome and more streamlined regulation and improved governance standards which provide protection to business interests
- > addressing corruption.

Responding to these constraints with a robust and effective reform agenda constitutes a daunting challenge for PNG, and for the aid program. But this is fundamentally where the program needs to be positioned. A key role for the aid program is to support identifying the key priorities that need to be addressed first, and, in concert with government and other donors, to support the effective and consistent implementation of initiatives to address them.

Setting out the detailed steps by which this could be achieved is beyond the scope of this report.

³⁹ *Ibid.*

One practical way to progress this is to establish a technical economic team, with representation from Australia and PNG, and possibly other parties, such as academic economists familiar with PNG issues, the World Bank and ADB—with a mandate to identify and prioritise the key constraints to growth and to recommend a sequenced program to address these constraints, consistent with affordability. The results of this work would constitute an important agenda for the annual aid High Level Consultations and Ministerial Forum, with a commitment on both sides to reach an agreed implementation agenda.

POSITIONING THE AID PROGRAM TO SUPPORT STRONGER GROWTH

INFRASTRUCTURE

While there is no single view within the Government of PNG about what focus the aid program should have in fostering and sustaining economic growth, supporting the development of infrastructure (particularly roads, but also communications, airports and sea ports), is consistently stressed as the key priority.⁴⁰ Other priorities expressed include maintenance of important existing road assets and new roads (especially where these would assist market access). In addition to the direct growth benefits of roads—linking people, products and markets—the strong spin-off benefits to other sectors such as law and order, and health and education, are emphasised. As the PNG Treasurer observed, once there are roads, issues such as rural unemployment begin to take care of themselves.

In most parts of the country road maintenance, particularly funded by provincial governments, is almost non-existent. And it is not clear that inter-governmental funding arrangements provide an adequate guarantee that roads are being maintained in line with overall resource availability and the importance attached to this sector.

While the importance of roads is agreed, just how this priority should be pursued, and how donors can best work with the PNG Government is not

clear. One senior official indicated that ‘PNG is not building any new roads under the MTDS, just maintaining the ones that link areas of high return.’ Key infrastructure expenditure programs in the transport sector referred to in the MTDS include the:

- > District Roads Improvement Program (DRIP)
- > Highlands Highway Rehabilitation Project
- > Community Water Transport Project
- > Airport Maintenance Project.

A current AusAID funded study—the Transport Infrastructure Priorities Study (TIPS)—is formulated against the prevailing circumstances of severe deterioration of much of PNG’s major transport infrastructure and highly constrained PNG Government public expenditure capacity. Accordingly, the TIPS is designed to assist PNG, AusAID, and other donors with robust identification of the physical infrastructure assets across the whole transport sector, which are vital to PNG’s economic growth. The TIPS is intended to establish the parts of assets that warrant top priority attention for restoration, rehabilitation and maintenance.

Although substantial, the aid funding provided to PNG by Australia (and other donors) can only supplement the funding requirements for major infrastructure works such as roads. PNG’s commitment to the importance of roads, or any other sector, must be reflected in the allocation of its own domestic resources if progress is to be made.

TARGETED INTERVENTIONS

The current MTDS identifies the following sectoral expenditure priorities for 2005–2010:

- > rehabilitation and maintenance of transport infrastructure
- > promotion of income earning opportunities
- > basic education
- > development-oriented informal adult education
- > primary health care
- > HIV/AIDS prevention
- > law and justice.

⁴⁰ Rehabilitation and maintenance of transport infrastructure is identified in the MTDS as a top expenditure priority for 2005–2010. . The 2005 PNG National Budget shows 26.6 per cent of the Development Budget (of which more than 80 per cent is provided through donor grants) is provided to the infrastructure sector already.

The PNG Government has emphasised the importance of impact projects as a means of accelerating growth. Many such projects are referred to in the MTDS—for example, against the priority of promoting income earning opportunities and supporting the development of industrial parks in key economic regions.

An issue for the aid program is how to respond to this emphasis. There is some call within PNG for the aid program to support the impact projects initiative as a priority, by supporting targeted interventions in particular industries, sectors or activities (mainly in agriculture). It was suggested, for example, that the aid program could support agriculture through dissemination of information technology (for example, farmers groups and industry organisations), improve agricultural material (for example, livestock breeds), and support feasibility studies of possible impact projects.

While there are some areas where such interventions could be consistent with Australia's comparative advantage and expertise, in the current environment of poor infrastructure, weak governance and policy settings, and inconsistent implementation of initiatives, their priority and effectiveness needs to be carefully assessed. A clear focus on growth and strengthening the enabling environment for it, through well targeted infrastructure support and improved governance, appears to offer far more. The appropriateness and priority that might be attached to such interventions could be usefully included in the work of the technical economic team recommended later in this report. The contribution of specific interventions to sustaining and strengthening village agriculture is needs to be addressed.

INSTITUTIONS AND CAPACITY BUILDING

While some observers of development have argued that economic growth should be the single focus for aid (most commonly through support for agriculture), the more widely accepted view is that institutions and governance matter. Indeed, there is compelling evidence that poor governance and weak institutions constitute a major impediment to growth. As a senior PNG Minister has indicated:

'There is potential for growth in both forestry and fisheries in PNG, but the governance issues are difficult. In these sectors PNG needs governance not capital; capital is needed in infrastructure and social services.'

It is difficult to argue against the focus of the aid program on building the capacity of Government to deliver core public sector functions as a necessary prerequisite for sustained growth. This focus includes rebuilding the integrity and capabilities of the public expenditure management system and strengthening the central machinery of government.

POLITICAL GOVERNANCE

THE PNG CONTEXT

Like many post-colonial states, PNG's inherited system of governance structures, both political and bureaucratic, has shifted significantly. This shift reflects the fact that the framework of seemingly strong formal institutions was often inconsistent with pre-existing social forms, in particular networks of kinship and community which pervade the formal state at almost every level. In many parts of the country, local forms of social control are stronger than the order imposed by the state.

The political culture that has developed in PNG does not necessarily fit comfortably with the imposed Westminster system. It is a political culture that militates against the execution of institutional responsibilities under Western concepts by Ministers of Parliament (MPs). Instead, MPs elected by a kinship and community base that in most cases represents less than 20 per cent of their electorate, are expected primarily to provide returns to that constituency, once elected.

There have been attempts at reforming the political system, such as through changes to rules governing the electoral and party systems introduced in 2001 and the more recent introduction of limited preferential voting. These reforms have been plagued by weaknesses in implementation, and their impact remains to be tested.

Beyond issues of culture and behaviour are important structural questions, particularly about the functions, responsibilities and relationships of the three tiers of Government. Under the Organic Law on Provincial and Local Level Government, responsibility for a number of important service delivery functions rest with the provinces. The confusion and uncertainty about responsibilities, and the clear evidence that equitable funding arrangements to support these decentralised responsibilities have not been developed or implemented, contributes to weak governance and deteriorating service delivery across the country. This is an issue for the aid program: the effectiveness of efforts to support service delivery is being undermined by the weaknesses of the Organic Law arrangements.

POSITIONING THE AID PROGRAM TO SUPPORT POLITICAL GOVERNANCE

For the aid program, the implications of an analysis of Melanesian political culture include:

- > Appreciating that PNG is different to Australia. It is still a young nation and the integration of its fledgling formal institutions with pre-existing social forms is far from complete. This will be a long-term process and neither the process nor the end product will mirror Australia's way of handling matters.
- > Acknowledging that much of what influences the operation of PNG legislatures and the bureaucracies that serve them is beyond the scope of institutional strengthening and capacity building. Governance interventions at the bureaucratic or technical levels, while necessary in terms of restoring knowledge, procedures and norms, will often be subordinated in practice by the demands of political culture. The impact of interventions to strengthen governance will be gradual and long-term. Expectations should be realistic.
- > Having realistic expectations about interventions, to address weaknesses in parliamentary functions such as oversight or lawmaking (for example Public Accounts Committee and the Ombudsman Commission). While there may be growing

demand for these functions from the more organised urban segments of civil society in PNG, the emphasis on the technical aspects of parliamentary operation is often more important to donors than to local people.

That is not to say that weak standards of political governance are acceptable. The evidence from countries with good long-term growth achievements is that adherence to some core first-order principles is required if sustained broad-based growth is to be achieved. These principles include the rapid accumulation of capital, efficient resource allocation, technological progress, and sharing the benefits of growth. The common experience of countries that have successfully grown has been maintaining macroeconomic stability, moving towards integration with the world economy, providing investors with effective protection of property rights, and maintaining social cohesion, solidarity and political stability.

High standards of political governance are essential if these principles are to be implemented consistently and effectively.

PNG has many institutions designed to support effective governance. These include an Ombudsman Commission, a National Audit Office, the Public Accounts Committee of the Parliament, an independent judiciary, and non-government organisations—such as Transparency International—all of which focus on governance issues. The evidence, however, is that these are generally weak, particularly in that they are given little committed support or effective follow up.

In this environment it is tempting for donors to promote the setting up of further institutions as a means of advancing a stronger governance agenda. But, if anything, arguably PNG has too many institutions, working ineffectively. Governance priorities may be better framed in terms of making the most important institutions and processes work better. This would be consistent with the lessons learnt from LICUS experience to focus on fewer, more effective institutions and a realistic governance agenda. Affordability and right-sizing concerns also argue for limiting the number of institutions as a general principle.

A series of public sector reform blueprints for PNG over the last decade have argued the need to:

- > aggregate and streamline government functions as far as possible
- > focus on strengthening core central agencies and the machinery of government, including improving cabinet processes and coordinating between central departments and line agencies
- > focus on restoring existing systems and avoid introducing more change and new systems.

There is a need to strengthen institutions and processes. It is important for the delivery of the aid program to work through PNG systems and processes, not to set up parallel ones. This will be challenging and will require patience and perseverance. As a specific contribution to institutional strengthening, institution-to-institution links—such as Treasury and Finance twinning schemes—have a role to play. These links may be equally important from an Australian whole-of-government perspective in sustaining interest, awareness and involvement of Australian agencies.

That said, there may be instances where further institutions are needed. Restoring the capability of the former Institute of Public Administration to provide training of public servants could serve to strengthen technical, ethical and governance standards in the public sector.

Much of the aid program's budget management and public sector reform work of recent years necessarily has focussed on the supply side of governance, which emphasises building leadership and management capacity in key central agencies and provides technical support to reform. More recently, the aid program has begun to strengthen demand for improved governance through:

- > increased support for churches and non-government organisations to deliver services and to pressure national, provincial and local governments for better service delivery
- > support for the media sector, particularly rural radio, to improve access, content and voice
- > support for fairer and more representative elections and political representation, including

through support for the implementation of PNG's new limited preferential voting system and for voter education to build popular understanding and demand for political accountability

- > strengthening oversight and accountability bodies like the Parliament, key Parliamentary Committees (especially the Public Accounts and HIV/AIDS committees), the National Audit Office, and the Ombudsman Commission, which provide avenues for public scrutiny of government functions.

There is growing interest in the role civil society groups and non-government organisations might play in countries such as PNG. Currently in PNG church agencies provide something like 40 per cent of school education and 45 per cent of health services across the country (although their reach and effectiveness is significantly determined by the availability of government funding). The key question is whether the aid program should be supporting such organisations to play a stronger role as alternative channels for service delivery and/or as agents to demand greater transparency, accountability and stronger performance from government. Some international evidence suggests it is unrealistic in fragile states to assume government systems can carry the burden of service delivery, and that the starting point should be to strengthen what works. The conclusion is there will be times when it will be necessary to bypass the state altogether.

Community and civil society groups argue that not enough aid is reaching the people of PNG. They say that working through government structures blocks aid getting to the people. A World Bank policy note argues that when '[f]aced with weak state capacity there is a compelling case for providing services through non-governmental providers'.⁴¹ And community groups in PNG advocate that a much larger amount of aid should be delivered through NGOs and civil society organisations. This view is also widely held in Australia and attracts considerable support, particularly in response to frustration with poor government performance in service delivery.

Support for a greater focus on community organisations as key service deliverers essentially

41 *Good Practice Note for Development Policy Lending: Development Policy Operations and Program Conditionality in Fragile States*. Page 18: World Bank. June 2005.

reflects a lack of confidence in government processes and systems in PNG and a lack of confidence that these can be reformed and strengthened. It also challenges the central question of what the role of, and what the fundamental obligation of, government(s) should be.

The wider involvement of community organisations is appealing, but the implications and consequences of proceeding further in this direction in any significant way must be weighed carefully.

With the exception of the churches, these organisations are not large or well organised in PNG. Their reach is limited, both in geographic coverage of the country, and their sectoral involvement. Community organisations can undoubtedly provide effective service delivery in pockets, but none offer wide-reaching delivery networks. There is little reason to think that if given a much more demanding mandate, they would not suffer from same weaknesses as government systems, including weaknesses in governance.

One consideration is the governance implication of supporting community organisations to deliver key services to the exclusion of government processes, systems and networks. There is a broad international consensus that, at a minimum, it is the role of Government to ensure that merit or public goods and services are accessible to citizens. This may entail direct delivery of services or support to other agencies in conjunction with safety nets. More widespread use of NGOs in service delivery would weaken the pressure on government to perform—that is, the governance imperative would be taken away and would leave Australian aid at the sharp end of service delivery. It seems more logical to view these organisations as important and valuable partners—of government and donors—in a more effective service delivery network and to support them in areas (geographic and sectoral) where they demonstrate particular strengths, but not as alternative networks which might replace reliance on government systems. An appropriate challenge for the aid program is to consider how to support stronger cooperation between Government and non-government service delivery agencies, underlined by the responsibility of Government to ensure services are provided.

There also appear to be prospects for greater involvement of the private sector in delivering basic services. There is already some involvement, particularly by mining companies, in providing health and other community services in local areas. In locations where there are reasonably large private sector operations, they could be used more deliberately as implementing agencies in the same way there is some scope for community organisations to be involved. But again, the private sector does not offer a national network which would support consistent and equitable service delivery across the country.

Given the well documented failures of governance in PNG, it is notable that there is not stronger and more effective demand from community and civil society organisations for greater accountability and performance, particularly from urban citizens. While it is essential to generate more consistent demands for improved performance, and there is scope for the aid program to support initiatives in this area, the lack of this demand at present is further indication that these organisations are relatively marginal in their capacity to influence the national agenda.

It is difficult to identify empowered constituencies which might effectively demand greater performance and accountability by government. There is some evidence from Africa of universities playing this role, but this is not clearly evident yet in PNG.

THE ORGANIC LAW ON PROVINCIAL AND LOCAL LEVEL GOVERNMENT AND DECENTRALISATION

As an issue of political governance, the arrangements under the 1995 Organic Law on Provincial and Local Level Government need to be reviewed. One senior Minister has observed that ‘the political structure and makeup of PNG hasn’t been right since independence.’

Under the Organic Law, responsibility for national functions such as defence and economic management have been reserved to the National Government, while responsibility for many key areas of service delivery in such areas as health and education have been vested in the provinces. The Organic Law provides a funding arrangement, including provincial revenue-raising powers

and formula-based transfers from the National Government to support this decentralised approach to service delivery.

Implementation of Organic Law provisions has been haphazard and inconsistent. Confusion remains over responsibility for many functions and funding arrangements have proven unaffordable and inequitable. The results have been large inequities between provinces because of differing provincial revenue bases (in particular associated with mining royalties), buck-passing between tiers of government encouraging a lack of transparency, avoidance of responsibility for performance, and a further deterioration—in some regions a complete collapse—in service delivery.

The aid program has developed a Sub-National Initiative (SNI) in response to the challenges created by Organic Law arrangements and supports the work of the National Economic and Fiscal Commission (NEFC) in reviewing the financial arrangements between the national and provincial governments. The SNI initiative builds on experience from sector-wide programs and recognises that the responsibilities for service delivery now rest with the provinces. It also acknowledges that improved service delivery outcomes require the strengthening of provincial government capacities, as well as those at the centre. The initiative has three objectives:

1. improve the National Government's ability to support and supervise sub-national levels of government
2. support sub-national levels of government to meet their service delivery mandates
3. improve the impact of the aid program by increasing consultation with both levels of government and improving coordination between program sectors.

The SNI is to work together with PNG's Provincial Performance Improvement Initiative (PPII), designed to strengthen the capacity of Provincial Administrations to carry out their responsibilities under the Organic Law more effectively.

There are important questions about whether the focus of SNI and NEFC work is consistent with the more recent direction of the National Government.

The National Government's sub-national focus now appears to be on districts rather than provinces. The indications are that the National Government is looking to ensure services are delivered by setting up Districts Treasury offices and instituting District Service Improvement Programs (districts are not a level of government under the Organic Law. A district is the electorate for Open members of the National Parliament).

Other views indicate that the wider reform agenda under the revitalised National Monitoring Authority initiative is based on a whole-of-government approach which includes a strong focus on the machinery that gives advice to government at a provincial level. This initiative is aimed at strengthening sustainability and capacity at the provincial level.

The Organic Law vests provinces with responsibility for important areas of service delivery, such as important components of health, education, agricultural extension, and road maintenance. Therefore it is not clear how a greater focus of the National Government on districts aligns with the more effective delivery of these services. The immediate issue for the aid program is whether SNI and NEFC work is proceeding on the basis of shared objectives with the National Government.

But there is a fundamental longer term issue—which type of decentralised structure will best support stronger performance in PNG? This is a relevant issue in the thinking about the positioning of the aid program over the medium term.

The World Bank has advocated decentralisation as a means of improving accountability for local service delivery but has noted that the modalities need to reflect the circumstances of the country. The evidence in PNG, where decentralised arrangements are contributing to worsening service delivery, is that the 1995 Organic Law model is flawed. To illustrate: in 2003, it is estimated the provinces spent K40 million on politicians, and K5 million on rural health services.

This is not just an issue of political governance. It is a critical consideration in stability and cohesion, service delivery and opportunities for growth.

STABILITY

PNG is a young country and the nation-state is still forming from a fragmented base of more than 800 ethnic and language groups, many of which have long histories of conflict and competition with one another. Much of the country remains geographically isolated and inaccessible and communications infrastructure is limited. Internal stability remains a concern. The Highlands region, in particular, is unstable and afflicted by regular tribal fighting and lawlessness linked to political competition over access to resources. The secessionist movement and conflict in Bougainville resulted in autonomous arrangements (and likely eventual independence) for that province, which are generating autonomy demands from other provinces.

Internal violent conflict in places such as the Southern Highlands, fuelled by political competition and the spread of guns, also threatens stability and key resource assets. Natural disasters such as the Tsunami, volcanic eruptions and drought continue as ongoing threats, and the capacity to prevent and mitigate their effects, and deal with their consequences, remains weak.

Strengthening the cohesion of the nation will rely on consolidating the legitimacy, relevance and authority of the National Government. While this institution of parliament provides the symbol of national government authority, the reality is increasingly very different.

At the most fundamental level, the relevance of the National Government to the people of PNG depends on the evidence of the Government as an active and relevant contributor to their well being, through delivery of basic services such as health, education, law and order, and infrastructure. At this level, there are profound weaknesses: service delivery from both national and provincial governments has deteriorated to the point where, in many parts of the country, there is virtually no day-to-day connection between people and government. The implications of this for stability are real.

In part this is associated with PNG's lack of growth since independence, and the resultant limited fiscal capacity of government to meet the needs of a rapidly growing population. But it is clear

that policy settings, government priorities, and governance weaknesses exacerbate this situation. The constitutional structure of government is a further barrier.

Stability is, of course, inter-related with growth and governance. One view is that the district focus would provide the most effective way of reconnecting the people at village level with the National Government (the actual word used was to strengthen 'control'). The increasing irrelevance of the National Government to the lives of people across the country is, of course, an extreme concern. The response needs to be very carefully designed.

Political governance and political stability are not interchangeable. The current National Government appears likely to run its full five-year term in office. If so, this will be the first time since Independence that an elected government has completed a full parliamentary term. That is an achievement, but it would be premature to claim it as evidence of greater political stability. There has been substantial instability in the composition of Government and the National Executive Council over the period. More importantly, the longevity of the National Government has been accompanied by on-going weak governance, deteriorating service delivery and weak growth.

Secessionist pressures, or at least pressures to change the nature of the political relationship between some regions of the country and the nation as a whole, continue to manifest themselves from time-to-time. Some are the result of the settlement reached establishing the Autonomous Government of Bougainville. Others reflect a strong regional, local or clan desire to maintain control over resources, particularly the royalty flows associated with large mining developments. At present some of these demands, such as the greater autonomy claims from East New Britain, are being progressed through peaceful and democratic processes, while others, particularly in the Southern Highlands, have generated violence and conflict.

POSITIONING THE AID PROGRAM TO SUPPORT STABILITY

Australian assistance has played a key role in bringing peace to Bougainville, in promoting stability and building confidence in the peace process and post-conflict recovery. Australian aid has had a high profile in supporting the establishment of the Autonomous Government in Bougainville, and this remains a priority of the aid program.

The program has also supported conflict prevention measures in the volatile but economically important Southern Highlands province. These included substantial financial support for enhanced security in the 2003 supplementary elections and support for conflict resolution work by local NGOs, churches and relevant national departments, to minimise the impact of poor governance and instability. Specific support through the aid program for the maintenance of order in the Southern Highlands has not been as obvious as has been the case for Bougainville.

While there will be opportunities for interventions to promote peace and stability, the most effective on-going response of the aid program to issues of instability is to support stronger broad-based growth, improved service delivery and more effective governance—that is, to strengthen the capacity of the state to meet the needs and aspirations of its people. In this sense, failure to lift performance in these areas will inevitably generate further instability and contribute to a further downward spiral.

IMPLEMENTATION OF THE PROGRAM

While the aid program has supported positive outcomes, particularly in consolidating the peace process in Bougainville, it cannot be said that since Independence, PNG's overall progress and achievements have been consistent with expectations—nor do they reflect satisfactory outcomes in overarching program objectives.

This is not to say that the program has failed or that its objectives are inappropriate. There are limits to what an aid program can achieve. But notwithstanding the level and direction of aid support, PNG's performance has continued to be

weak in growth, service delivery and governance. By many measures, its performance is deteriorating.

The fundamental questions confronting the aid program over the next five to ten years are why PNG's economic and social progress has been so disappointing, why governance remains so weak, and whether Australian aid can provide more effective support for stronger outcomes.

THE SIZE AND REACH OF THE PROGRAM

The Australian aid program to PNG is substantial in absolute size, although in per capita terms it is not as large as aid programs to many Pacific countries. Nevertheless, the program dominates total aid flows to PNG—about 80 per cent of all aid to the country is from Australia. The program reaches widely across many areas of activity in PNG, from remote, small-scale community social sector projects, to rehabilitation of the Highlands Highway, through to working with Government on economic policy and governance reform. In some sectors, the program provides virtually the only funding for goods and services reaching people in outlying regions of the country.

Providing substantial aid over a long period has contributed to generating expectations within Australia that better outcomes should have been achieved. The most instinctive response is that the program has failed.

The program has certainly failed to generate the kind of progress expected, but a more balanced conclusion may be that expectations have been overly simplistic and unrealistic. Put simply, in the PNG environment since Independence, and more particularly in the last ten to 15 years, there are real limitations to what could have been achieved. While it is not possible to observe the counterfactual scenario of how PNG would have fared in the absence of aid over this period, it is most unlikely that performance would have been stronger without aid.

Arguably, the breadth of the program, with its reach into nearly all sectors of activity, has undermined rather than underpinned improvement in some respects. In some sectors, and some parts of the country, the availability of aid intervention has

encouraged the substitution of aid for the use of PNG's own resources, allowing the latter to be diverted to other, often lower priority, uses. The availability of aid funding for pharmaceuticals, textbooks and road maintenance are examples of aid interventions which have facilitated substitution of donor resources for government support. Since aid funding was never going to be adequate to sustain effective service delivery programs across the country, this substitution has been associated with ongoing inadequate performance.

The Development Assistance Committee (DAC) of the OECD has observed that some level of aid dependency would certainly hurt the real economy. In the case of PNG, it would be drawing too long a bow to claim that this was the case with the Australian aid program, but it is certainly the case that the program has not worked well enough with PNG's own resources, with common priorities and in support of common objectives, and has thus failed to generate the more positive outcomes that should have been possible.

The World Bank and the ADB have suggested that the size and reach of the Australian aid program has also had implications for the involvement of other major donors. The banks have indicated that the size, role and pervasive presence of Australia's aid program, and the differing objectives and operational and governance requirements, have made it more difficult for them to work in PNG. In essence, the banks have suggested that Australia's consistent delivery of a \$300-million-a-year aid program, effectively without enforcement of performance requirements, has weakened their capacity to insist on the Government meeting obligations, or other conditions for lending, and has thus squeezed them out. There are other issues for the banks, but these observations bear some consideration.

FOCUS AND POSITIONING OF THE AID PROGRAM

The breadth of the aid program may also have contributed to a failure to leverage stronger overall performance by the PNG Government. The flexibility

of the program (which, in part reflects its size), and a genuine and well-intentioned willingness to respond to emerging issues of need, has clearly generated expectations among some groups in PNG that the resources of the aid program are available if representations are made. This contributes to a sense that the program can, and will, pick up whatever needs are not catered for by PNG's own programs. In some cases, it appears that the aid program is seen as the preferred point of first call.

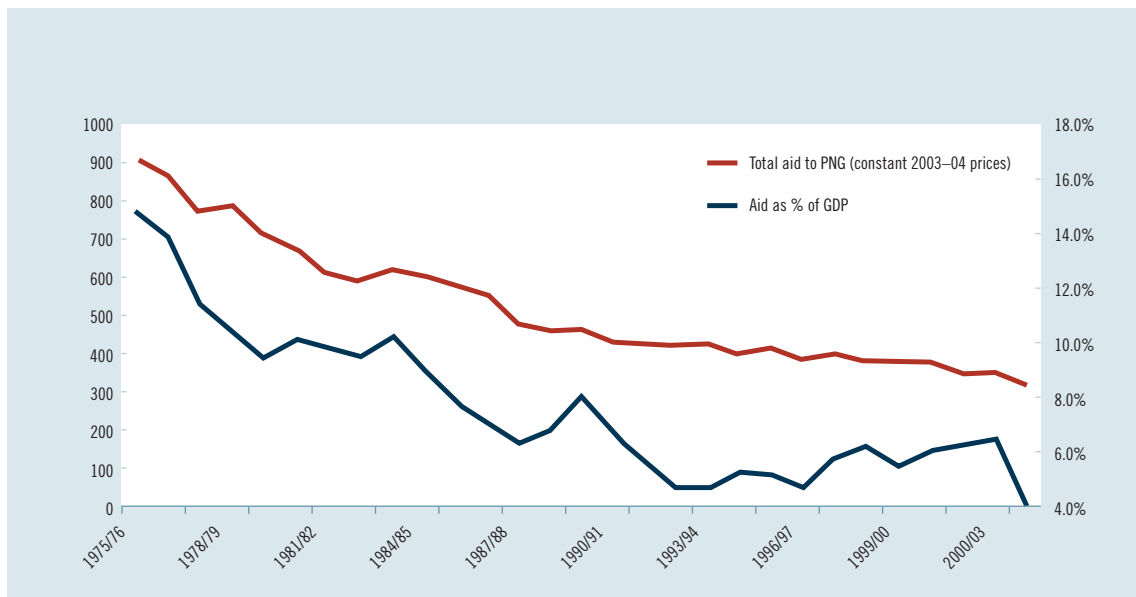
The 2004 Joint Review of the Australian Aid Program to PNG noted that: 'The capacity of the program to respond positively when particular issues arise does contribute to the impression that it is all things to all people.'⁴² One of the more important implications flowing from this perception relates to the incentives for the PNG Government to accept responsibility for the roles it should reasonably be expected to assume. As the Joint Review observed: 'There is an argument that the program has stepped in to fund particular activities for which the Government of PNG itself should have accepted responsibility'.⁴³

Australia is not responsible for service delivery, or particular outcomes in PNG. The only effective and sustainable contribution of the aid program is to complement and support the work of the PNG Government in meeting its responsibilities and objectives, not to supplant it. In the area of service delivery, arguably the aid program needs to force itself further away from the mindset that it must take responsibility for everything that goes on in PNG. This is particularly relevant given the continuing decline in the value of the aid program (excluding ECP) to PNG in real and relative (to GDP) terms as shown in Figure 2. For those working on the program's design and implementation, it may be difficult to accept there are areas of intervention for which the program has previously accepted at least some degree of responsibility that would no longer be continued. Of course, a stronger focus on growth and governance carries this same clear implication. The greater the focus on other matters, the less the

42 Joint Aid Review, *op cit* page33

43 Ibid

Figure 2: Australian aid to Papua New Guinea 1975–2004 in real (A\$ millions) terms (LHS) and as proportion of PNG GDP (RHS)



program will be able to support involvement in a wide range of service delivery activities.

There must also be questions about how far the internal managerial and technical resources in AusAID can be stretched across a broad agenda without negative consequences for the impact of the program.

A clearer focus for the Australian aid program (and in this context clearer means narrower), coupled with firm governance arrangements, should facilitate the stronger involvement of other donors who may be better placed to deal with particular aspects of the challenges associated with promoting growth. For example, the World Bank may be able to make a stronger contribution to promoting private sector development, and the ADB in supporting infrastructure development.

A common observation of the many studies undertaken of the PNG Government's public expenditure management is the need for stronger, more effective and more consistent performance. In essence, the evidence over the last 15 years or so is that fiscal policy has been weak and inconsistent, and that inadequate attention has been given to the quality of expenditure. An aid program cannot work effectively in an environment of weak fiscal policy, and certainly cannot substitute for it.

Going forward, an essential feature of the aid relationship must be that aid works effectively with PNG's own resources, in support of agreed objectives and priorities. A carefully constructed compact which sets out the role the aid program is to play in supporting PNG's own efforts—and the responsibilities which the Government will meet through its own efforts—would provide much needed clarity. Any compact would require performance benchmarks which should be realistic, achievable, and agreed with PNG through consultation—not imposed unilaterally. This would require revisiting the existing Treaty on Development Cooperation and strengthening some of its key provisions.

EMERGING PRIORITIES FROM FRAGILE STATES AND OTHER INTERNATIONAL EXPERIENCE

The World Bank includes PNG in its grouping of fragile states (or LICUS). Whether this term should be applied to PNG, it is reasonable and appropriate to look at lessons learnt from experience with fragile states in thinking about the parameters within which the aid program might be positioned and progressed.

Recent research on fragile states has concluded that, without assistance, fragile states have little prospect of overcoming their problems and are likely

to experience ongoing fragility and stagnation for generations.⁴⁴ The conclusion from these, and other studies, is that donors must invest in fragile states to avoid further deterioration, addressing aspects such as law and order, service delivery and improved public administration and political governance.

The United Kingdom's Department for International Development (DFID) has noted that because fragile states have difficulty absorbing large amounts of aid, there is a need to focus on areas where capacity is least weak and on removing barriers to the effective use of future support. Policy reform needs to be carefully planned so as not to overload fragile institutions.

This analysis has given rise to the concept of 'good enough' principles which has relevant messages for thinking about what might be appropriate in PNG and how an aid donor should proceed. These principles are to:

- > encourage focus on the main causes of instability and main capacities of the state
- > aim to achieve visible results in the short term (to build momentum for future reform); avoid the most politically or socially controversial issues (because these may weaken the momentum for reform)
- > avoid reforms that are too ambitious
- > ensure reform does not erode existing capacity
- > strengthen accountability and the legitimacy of government.

The aid program needs to reflect these principles in its design, implementation and expectations. Arguably the program in the past has been too ambitious, too broad and has sought to progress too many objectives without regard to sequencing to support the most important priorities. These are important building blocks for an effective country strategy for the aid program.

CENTRAL AGENCIES AND THE MACHINERY OF GOVERNMENT

PNG cannot effectively address the challenges it faces without the effective functioning of the central machinery of government driving a coherent and affordable agenda. The effective performance by line agencies and provincial governments requires effectively functioning central agencies working cooperatively and consistently. The performance of central agencies will have an impact on PNG's ability to generate growth, its success in lifting standards of service delivery, improving governance, and in strengthening the cohesion of the nation. It is an essential prerequisite for aid effectiveness.

The design of the ECP recognised the importance of central agencies and the machinery of government. While the immediate outlook for ECP is unclear, the aid program must maintain its engagement with central agencies as an essential ingredient to improved performance.

OWNERSHIP AND AFFORDABILITY

The PNG Government generally acknowledges that the aid program cannot solve the country's problems and that it has to take ownership of its own destiny and provide the vision and direction for achieving it. The aid program cannot work effectively in the absence of a coherent and prioritised agenda, developed by and within PNG, and to which there is strong ownership and commitment. 'Programs should be selective, focusing on a modest reform agenda where there is sufficiently strong national ownership.'⁴⁵ If these conditions exist, the aid program can have a real impact.

The importance of ownership needs to be recognised in the way Australia engages with PNG. While PNG may (or may not) accept a program developed against the perspectives and priorities of donors, it is unlikely to own it. Donors must find a way to engage with the country constructively and comprehensively over priorities and roles. And they must do it early.

44 Chauvet, L. and Collier, P (2005) 'Development Effectiveness in Fragile States: Spillovers and Turnarounds', Paper prepared for DAC Learning and Advisory Process on Difficult Partnerships

45 Good Practice Note for Development Policy Lending: op cit - page 10.

The cooperative development of a program must also reflect affordability. PNG will have its own legitimate priorities which will not always be consistent with the priorities of donors. Affordability means that priorities are adequately resourced; this in turn means that not everything can be supported.

The aid program needs to be developed in a way that supports ownership and affordability.

COMPACTS AND PERFORMANCE MANAGEMENT

Today there is lack of clarity and wider lack of understanding in both Australia and PNG about what the aid program can achieve in PNG, and the environment required within the country to make it more effective. A well-structured mutual performance obligation framework would facilitate much greater transparency in the program, and would make much clearer to all concerned what the mutual expectations were, and how the commitments of all parties were to be progressed. In short, such a framework would clarify what each party had undertaken to do, and would provide a basis for monitoring and evaluating performance.

The application of compacts, or other performance measures to establish clearly how aid will work with PNG's own resources, and how the effectiveness of interventions can be assessed would strengthen the aid relationship. DFID has observed generally that well targeted sanctions may have some impact on the pace of reform, and the 2004 Joint Aid Review noted that the principle of mutual obligation has value for both governments. Conditionality can be helpful if it bolsters a government's case for implementing policy measures to which it is already committed and helps to operationalise its strategy.⁴⁶

Applying performance benchmarks to the aid program is required under the provisions of the Development Cooperation Treaty, but this has not been consistently achieved. The scale and reach of the program in PNG makes this an important issue. Establishing compacts to guide and monitor performance was also a feature of the proposed JCS with the World Bank and the ADB. Recent

discussions at officer level have highlighted resistance within PNG to the concept of broad-based performance measures, largely on the grounds that these impinge on sovereignty. A compact is not to undermine sovereignty, but rather to enhance it. Meeting the basic needs of citizens and responding to their aspirations is fundamental to sovereignty. A compact which strengthened performance in this direction, and which was developed cooperatively between the two governments, is consistent with sovereignty. A programmatic approach, with a sequence of operations, may be appropriate. 'A programmatic approach would signal commitment from Australia (and potentially other donors) as well as by the Government of PNG, offer some predictability in funding, and progress could be mapped out in small steps'.⁴⁷

Sensible and well-constructed compacts, which included agreed requirements for monitoring and evaluation, would not only provide a benchmark for donors to monitor and assess performance, they would also support PNG's own efforts in areas where it acknowledges the need for improvement. Correctly determined and specified, there is nothing objectionable in the notion of a compact which establishes mutual obligations and performance expectations.

The essence of a compact is that institutions do what they are supposed to do. As such, it should be possible to embed compact principles as something within the PNG system which PNG values.

Compacts would apply at different levels. At the highest level a country-to-country/government-to-government compact would establish the framework within which development assistance would sit. Negotiated cooperatively, this would establish the commitment of the Australian Government to support PNG's development objectives through agreed interventions, and the PNG Government's commitment to accept responsibility for achieving progress in agreed areas and undertaking agreed functions and activities. At this level the language might be about shared aspirations and objectives. It might be about agreed processes and directions. The

⁴⁶ *Ibid*, page 11.

⁴⁷ *bid*, page 8

language would be looking for evidence of direction and commitment to policy and commitment to implementation, rather than specific milestones.

Such a compact would set out the expectations of both governments, and the circumstances of performance which might give rise to incentives (such as additional aid funding), or non-performance, under which sanctions (such as partial withholding or reduction of the aid program) would be applied. It would be logical to assume that an overarching government-to-government compact, would espouse broad principles and values—such as ‘supporting stronger broad-based growth’, ‘eliminating corruption’, ‘improving transparency’, ‘improving standards of governance’, ‘strengthening law and order’, ‘improving service delivery’, and ‘reducing the size of the public sector’.

The principle underlying compacts would logically extend in more specific terms to government demanding that its parts perform—for example, central agencies (Central Agencies Coordinating Committee [CACC] and National Executive Council [NEC]) requiring performance from each other and from service delivery agencies. At this level, specific compacts could cover key sectors or programs with specific performance targets.

In negotiating a compact which would embrace the aid program overall, PNG’s weak capacity and weak management at all levels needs to be recognised. If the bar is set too high, any initiative will fail.

The concept of a compact requires the capacity to evaluate performance. The more specific and detailed the compact, the more precise the performance measures can be.

By way of illustration, a compact approach to strengthen performance management and position the aid program could include:

- > Identification of sectoral priorities (for example, infrastructure and national roads that provide linkages to markets). These will reflect PNG Government priorities (for example, as set out in the MTDS) and the priorities of the aid program.
- > Agreement on activities to be supported by the aid program and an indicative level of support as well

as agreement on the level of support to come from PNG and activities to be undertaken by PNG.

- > Assessment of the level of appropriation in the National (and provincial) Budget for functions to be undertaken by PNG. Are these consistent with the MTDS? Are they consistent with a level of commitment which warrants Australian support?
- > Monitoring of budget implementation against appropriation—that is the actual expenditure (warrants) to be monitored.
- > The agreed level of Australian support would be subject to PNG meeting its undertakings in actual expenditure performance against the agreed priority areas.
- > The inclusion of AusAID in Quarterly Budget Reviews. This would enable informed monitoring of performance of the agreed compact.
- > Following the Third Quarter Budget Review, issues relating to implementing the agreed compact performance would be examined by the Country Effectiveness Review (as recommended by the Joint Aid Review)—leading to agenda discussion at high level consultations on the annual Ministerial Forum.

Where progress is uneven, assessment should be based on an overall assessment of progress.⁴⁸ Other elements which could be incorporated in this approach could include:

- > Australia assuming responsibility for specific sectors subject to the Government of PNG meeting agreed commitments in other areas.
- > Australian support reflecting overall macroeconomic management performance and policy directions.

The suggestion that AusAID be part of the budget review process should not be seen as interference in PNG’s procedures. If the two governments are to work effectively together and, most critically, to leverage the strongest outcomes from the complementary use of resources, it is essential that both are fully and equally informed about fiscal conditions and progress in budget implementation. Similarly, the notion that Australia might assume responsibility for specific sectors is not to challenge

48 *ibid*, page 12

PNG's sovereignty, but rather to maximise the positive impact of the resources available. Any move in this direction would be based on agreed roles, responsibilities and contributions.

MODALITIES—DELIVERY MECHANISMS

A theme running through this report is the need for consistency. This also applies to aid modalities—the way aid interventions are designed and implemented. The 2004 Joint Aid Review noted that changes in priorities and efforts to improve aid effectiveness through new modalities have too often caused confusion and uncertainty. It observed that interventions need time and commitment to work. While this observation would most commonly be understood as a call for consistency in priorities and direction, those involved on the PNG side in the management of the aid program, argued equally forcefully for consistency in modalities.

Consistency does not mean there should be no change. For example, working more closely with recipient government systems and channelling aid through recipient government channels—such as in the case in the sector-wide approach in health in PNG—has, of necessity, required change. Changing delivery modalities can yield substantial gains in recipient ownership, efficiency, effectiveness, and sustainability of outcomes. However, to the extent possible, change should be evolutionary rather than revolutionary in nature. It should be carried out following full consultation with all parties, and continual change should be avoided. The reasons for and benefits of change may not be embraced as quickly within PNG as within Australia. And as mentioned above, the view from PNG is that consistency in delivery matters.

Debate over the most effective modalities for aid delivery continues. Over recent years there has been a shift by some bilateral donors, most particularly the United Kingdom, away from traditional project support and towards non-earmarked or untied general budget support. Multilateral agencies such as the World Bank and the ADB are redesigning their adjustment lending in similar ways, moving away from conditionality-driven support to more loosely targeted budget support in the form of Adjustable

Program Loans. Aid evaluations in the 1980s and 1990s have pointed to a litany of problems with traditional off-budget projects.

More generally, within the DAC there is recognition of the need to understand the political incentives and the institutions that affect the prospects for reform, and a view that aid modalities work best when they are matched with appropriate circumstances, with budget support often favoured for good performers. However, there is no consensus that one modality is superior to others in all circumstances, and no evidence which would robustly support any such conclusion.

KEY STRATEGIC PARTNERS: BETTER HARMONISATION

The benefits of donor coordination are obvious; achieving it is difficult, and the more it is talked up the harder it appears to be to succeed.

In 2002 Australia, the World Bank and the ADB sought to design a Joint Country Strategy with PNG (as discussed in Chapter 1). Notwithstanding the problems encountered with the JCS approach, better harmonisation among donors (and between donors collectively and PNG) is essential if full value is to be leveraged from donor support. Donors remain strongly committed to a joint approach in aid delivery. Even without a JCS the approach of donors to PNG working together has yielded some successes, notably:

- > Improved coherence of policy dialogue and advice from donors, particularly through the complex negotiations which led to the cancellation of the Forestry and Conservation Loan (World Bank) and the Public Sector Loan (ADB).
- > The development of a Public Expenditure Review and Rationalisation (PERR) which sets the basis for a range of initiatives by PNG and donors to tackle critical fiscal management and public sector reform issues.
- > Joint analysis in key sectors such as health, education and transport, providing a common platform from which to build integrated assistance.

Further joint work is being undertaken in the infrastructure sector and in particular Australia, the

World Bank and the ADB have agreed ‘in principle’ to a joint feasibility study of enhanced donor harmonisation within the PNG Transport sector which will be undertaken in the second half of 2005.

The World Bank and ADB can bring substantial intellectual resources and broad international experience to bear on policy issues in PNG, and AusAID may be able to leverage the Bank’s engagement by offering to co-finance certain activities. Co-financing may prove effective in narrowing AusAID’s direct focus, and gaining value-for-money and less intensive management in areas such as private sector development.

Australia has a long-term commitment to building relationships, engagement and frank dialogue with other donors to PNG. However, the benefits from a joint approach cannot be achieved unless PNG becomes fully engaged and supportive of donors working collaboratively together.

The different performance and governance requirements of the international financial institutions on the one hand, and Australia’s bilateral program on the other, may make it difficult for donors to develop and operationalise a formal joint Country Strategy, irrespective of the position PNG might take. More informal harmonisation and cooperation may offer a better prospect.

If Australia is to work more effectively with other donors, a mature judgement is required about the country’s comparative advantages as a donor. Australia’s comparative advantage may include its strong functioning democracy, sharing similar institutional and accountability systems, public expenditure management in government, geographic proximity (trade and access to government services), being the largest donor by an order of magnitude, and being a regional leader and an advocate for the Pacific outside the region.

Australia also needs to recognise the governance arrangements which support or limit the activities of others, particularly the international financial institutions, and ensure that its own engagement with PNG does not crowd out others.

COUNTRY STRATEGY

The *Papua New Guinea Country Strategy 2000–2003* sets out four key objectives: strengthening governance; improving social indicators; promoting sustainable economic growth; and consolidating the peace process in Bougainville.

The 2004 Joint Aid Review emphasised the role and value of the Country Strategy. It noted that: ‘Given the scale and scope of the Australian aid program, an agreed country strategy is essential to ensure there is overall balance and coherence in the program itself, and to ensure there is consistency with the development priorities of the Government of Papua New Guinea.’⁴⁹ The review also recommended that the Country Strategy should be a more operational document than it has been in the past, and should establish for both sides what the aid program aims to achieve over the period of the strategy.

Australian officials have indicated that the guiding principles of the new strategy will be:

- > consistent with LICUS/fragile states paradigm which underlines the importance of strengthening political governance, targeting corruption, building sustainable government institutions, exploiting opportunities to stimulate sustainable economic growth, and maintaining delivery of services to minimise the impact of system failures on the poor
- > consistent with the development priorities articulated in the PNG Government’s MTDS 2005–2010
- > informed by the findings of the August 2004 joint review of the Australian Aid Program—that is, a more operational document, guiding the implementation of the program.

Donor harmonisation issues will also feature strongly in the new Country Strategy.

At present, the joint progression of a new country strategy by officials of both countries working together has been impacted by on-going negotiations over the immediate future of the ECP. The observations of the Joint Aid Review appear appropriate and should guide this work over the coming months.

49 Joint Aid Review, *op cit*, page 67

3 Conclusions and recommendations

DIRECTIONS FOR AUSTRALIA'S AID ENGAGEMENT OVER THE NEXT FIVE TO TEN YEARS

IMPLICATIONS FOR THE AID PROGRAM: DRAWING THESE TOGETHER

This report draws three fundamental conclusions that should inform the future direction and positioning of the aid program in PNG over the medium term:

1. PNG must generate stronger economic growth
2. service delivery needs to be improved
3. governance must be strengthened.

PNG must generate stronger economic growth. Growth at nearly double the rates currently projected in the budget for the coming years needs to be achieved if poverty is to be reduced. Growth needs to be broad-based to maximise the direct impact on the lives of people across the country and to strengthen the Government's fiscal capacity to contribute effectively to the economic and social advancement of people across the country. Carefully prioritised programs and consistency of implementation are required. Overcoming constraints to growth is the key. The aid program must support growth if the capacity of the PNG government to deliver improved services is to be strengthened.

Governments at all levels in PNG must improve service delivery. This requires a stronger fiscal position overall, greater equity in access to funding for service

delivery, more effective operation of the decentralised service delivery framework, identification of priorities, and stronger and more consistent commitment.

Improving the enabling environment, strengthening governance and generating stronger growth are interdependent.

The stability and cohesion of the nation is at risk if these are not achieved.

The need to lift the availability of resources in PNG remains, and the reality that PNG faces huge challenges and costs in providing services cannot be ignored. However, more could be achieved with available resources. The inefficient, ineffective and inconsistent use of existing resources is frustrating better outcomes.

The aid program can be most effective if its focus is to support the PNG Government to overcome these weaknesses. Specifically, this suggests the program should focus on the following features.

SUPPORTING STRONGER BROAD-BASED GROWTH

A strong focus on addressing the binding constraints that have inhibited PNG's growth performance.

Priorities should be:

- > A stronger focus on infrastructure. This is consistent with PNG's own priorities as set down in the MTDS, but greater clarity is needed on the respective contributions of donors and PNG itself, including for infrastructure maintenance.

- > Other binding constraints. A manageable and carefully prioritised program of initiatives is required to address constraints which impede growth and development—with full cooperation of all parties and within the limits of what can be achieved without overwhelming capacity. A joint technical economic team, with representatives from PNG, Australia and possibly other donors such as the World Bank, could be tasked to produce a critical path analysis, including prioritised and sequenced actions required to address critical constraints to growth, consistent with the objectives of the MTDS. Genuine partnership and PNG Government commitment to implement the outcomes of any such study would be essential.

In supporting growth, the aid program must work in concert with other donors and draw on the comparative advantage of different donors, particularly the development banks. Critically, it must work in concert with the PNG Government and its use of its own resources. Clear priorities and expectations need to be established, supported by consistent implementation.

SUPPORTING PNG'S EFFORTS TO IMPROVE SERVICE DELIVERY TO THE MOST VULNERABLE—WITH REDUCED EXPOSURE TO, AND INVOLVEMENT IN, SERVICE DELIVERY GENERALLY

A stronger focus on supporting growth will require reduced and more focused support for service delivery. This implies that PNG must accept greater responsibility for service delivery generally. Priorities will need to be agreed upon and implementation monitored. Consistency and long-term support are required.

WORKING STRATEGICALLY TO IMPROVE GOVERNANCE

Interventions should recognise and reflect the practical reality of good enough governance. This means identifying key priorities, and focusing on practical issues, particularly strengthening the machinery of government.

The arrangements and functional responsibilities under the 1995 Organic Law on Provincial and Local Level Government need to be re-examined. The decentralisation framework established under

this law provides neither equity nor efficiency. It has contributed substantially to deterioration in service delivery, lack of transparency and accountability, and weak performance. The aid program can provide critical support, but there must first be clarity about the nature, extent and objectives of decentralisation.

Overall, there is a need for greater rigour in monitoring and evaluation aid effectiveness. This should be important to both governments. It is essential that Australia's aid efforts support PNG's own resources in delivering agreed priorities. A compact which sets out agreed priorities and mutual commitments and expectations of both governments would provide a framework for consulting, monitoring and evaluating. It is difficult to see how an aid program of the relative size and reach of the kind in PNG can be implemented with consistency and coherence without such a framework. A compact would be effective in ensuring the Country Strategy, when finalised, is appropriately operationalised.

The current aid program sits within the Treaty on Development Cooperation agreed between the two governments in 2000. Much has changed since then. Following the release of the White Paper it would be appropriate to review and, if necessary, renegotiate the Treaty. This report suggests that renegotiation is needed to position the aid program more effectively over the coming years.

Australia has consistently been clear that it will continue to play a long-term role as a partner in supporting PNG's development efforts. This is important. While PNG must generate stronger outcomes in the years ahead, this will be a long-term process, even under the most favourable circumstances.

Australia's long-term engagement must also come with consistency and patience. There are no quick fixes. Changing priorities undermines confidence and generates confusion. This in turn weakens prospects for positive outcomes. Unrealistic expectations similarly generate counter-productive frustrations.

Above all, engagement between the two countries, at all levels, needs to be consistent and constructive. Delivering a large aid program, which is critical in supporting and complementing PNG's own efforts, can only be effective if the spirit of mutual respect and cooperation is strong.

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Attachment II – Consultation list

IN PAPUA NEW GUINEA (PORT MORESBY MAY–JUNE 2005)

Meeting with Department of Prime Minister and National Executive Council

Felecia Dobunaba

Meeting with heads of agencies

Crispin Conroy (DFAT—Deputy Head of Mission), Leisa James (AFP), Dougal McMillan (Defence)

Meeting with Department of Planning

Valentine Kambori and others

Meeting with Program Support Unit (PSU)

Judith Ugava-Taunao, Emmanuel Wrakuale, Sam Talepakali, Moale Vagikapi, Janet Philemon, and others

Meeting with international financial institutions

Benson Ateng (World Bank), Steven van der Tak (Asian Development Bank), Ebrima Faal (International Monetary Fund)

Meeting with first secretaries

Stuart Schaefer, Kristen Pratt, Mike Hunt, Romaine Kwesius, Danielle Hienecke, Hannah Birdsey, Debbie Reschke, Richard Slattery, and others.

Meeting with PNG Treasury

Honorable Bart Philemon (Ministry for Treasury and Finance), Honorable Sam Akoitai (Minister for Mining)

Meeting with Department of Provincial and Local Government Affairs (DPLGA)

Secretary Gei Ilagi, Deputy Secretary of Technical and Monitoring Division, Tau Vali

Meeting with business community

Greg Anderson, John Leahy, Maryanne McDonald, Winifred Kanit, David Conn

Meeting with ECP Core Group

Meeting with Treasury

Acting Deputy Secretary Ms Nino Seruva (and three colleagues)

Meeting with Charles Lepanim

Meeting with AusAID project team leaders

Barbara Smith, Maxine Whittaker, Jenny Clement, Michael Ward, John Petit, Boston Coleman, Jane Davy, John Jarvis

Meeting with senior advisers to PNG Government agencies

Rob Crittenden, Andrew McNee, Kathy Whimp, and Fiu Igara

Meeting with Department Education

Dr Joseph Pagalio (Acting Secretary), Deputy Secretary for Policy and Administration, First Assistant Secretary, Assistant Secretary

Meeting with NGO—civil society representatives

Sisa Kini, Wayne Golding, Lawrence Stevens, John Nonggorr, Peter Aitsi, Scolla Warai Kakas

Meeting with Department of Health

Dr Nicholas Mann (Secretary of Health)

Meeting with university/academics

Dr Thomas Webster (National Research Institute), Mike Manning (Institute of National Affairs), Dr David Kavanamur (UPNG)

Meeting with Department of Community Development

Dame Carol Kidu (Minister for Community Development)

Discussions with Steve Hogg (on secondment from AusAID with Department for International Development, London)

In Australia (May–July 2005):

AusAID PNG Branch, Canberra

Meetings with senior officials from Australian Government departments and agencies, Canberra, including:

- > Prime Minister and Cabinet
- > Treasury
- > Attorney-General's
- > Foreign Affairs and Trade
- > Finance and Administration
- > Australian Federal Police

JTA International, Brisbane

Jane Thomason

Australia—Papua New Guinea Business Council, Brisbane

GRM International, Brisbane

Wayne Read, Peter McColl

Lowy Institute for International Policy, Sydney

Malcolm Cook

Asian Development Bank, Sydney

Naomi Chakwin

World Bank, Sydney

Cyrus Talati

Australian National University, Canberra (roundtable meeting with academics)

Andrew McIntyre, Satish Chand, David Hegarty, Sinclair Dinnen, Bob Cotton, and others

Attachment III – The evolution of Australia's aid engagement with PNG and its drivers

1. NATIONAL INTEREST CONSIDERATIONS

Australia has compelling strategic interests in a stable and prospering PNG. Australia shares a strong historical bond with its closest neighbour and its people. The economic, social and security interests of the two countries are linked.

The last ten years have seen rising poverty and instability in PNG, with 2.2 million Papua New Guineans now living on less than US\$1 per day, up from 1.1 million in 1996.⁵⁰ Despite substantial improvements since Independence in some key social indicators,⁵¹ overall PNG now has by far the worst social indicators in the Pacific.⁵² On the basis of its economic and social indicators, as well as indicators of institutional quality, PNG has been included by the World Bank as one of 26 countries categorised as LICUS— also known as fragile states. Other LICUS countries include the Solomon Islands, East Timor, Somalia, and Nigeria.

In recent years PNG has also seen positive developments, most notably the peaceful resolution of the Bougainville conflict, but also improved budget management and commodity prices during 2003 to 2004, improved political stability and recent signs of recovery in resource investments, especially the improved prospects for the Highlands Gas Project.

But huge challenges remain. PNG is facing difficult medium-term economic prospects, a breakdown in service delivery in many provinces, a looming HIV/AIDS crisis (with infection patterns resembling those of the early spread of HIV in sub-Saharan Africa), continuing environmental degradation, and a young population set to double over the next 20 years. Widespread and increasing youth underemployment, aggravated by increased rural-urban migration, is contributing to increased crime

and social tension. Internal violent conflict in places such as the Southern Highlands, fuelled by political competition and the spread of guns also threatens stability and key resource assets. Natural disasters such as the Tsunami, volcanic eruptions and drought continue to be ongoing threats and the capacity to mitigate their effects, and deal with their consequences, remains weak.

The potential spillover effects of this on Australia and the region have been well documented in international literature on fragile states and more particularly in the recent ASPI report on PNG 'Strengthening Our Neighbour'.⁵³ They range from geo-strategic concerns relating to Australia's defence, to more immediate concerns with the possible impacts on Australia of transnational threats such as cross-border crime, international terrorism, disease pandemics, and people movement.

Australia therefore has a big stake in a policy of enlightened self-interest towards PNG, that combines our humanitarian and moral obligations as the ex-colonial and as the metropole power in the region, with our strong economic and strategic self-interest in supporting PNG to deal more effectively with the challenges it faces. Recent research on fragile states concludes that without assistance, fragile states have little prospect of overcoming their problems and are likely to experience ongoing fragility and stagnation for generations.⁵⁴ A recent OECD study indicates that once a state becomes fragile, it can remain that way for around half a century and cost around \$80 billion to remedy. The conclusion from these and other studies is that donors must invest in fragile states to avoid deterioration, addressing aspects such as law and order, service delivery and improved public administration and political governance.

50 World Bank, Papua New Guinea: Interim Strategy Note, 2005.

51 AusAID (2003) 'The Contribution of Australian Aid to Papua New Guinea's Development 1975-2000', p ix

52 Ibid.

53 Australian Strategic Policy Institute: Strengthening Our Neighbour—Australia and the future of Papua New Guinea, 2004

54 Chauvet, L. and Collier, P (2005) 'Development Effectiveness in Fragile States: Spillovers and Turnarounds', *Paper prepared for DAC Learning and Advisory Process on Difficult Partnerships*.

2. THE EVOLUTION OF AUSTRALIA'S AID ENGAGEMENT AND ITS DRIVERS

Since Independence Australia has provided more than \$14 billion in real terms (\$9 billion in nominal terms) as official development assistance to PNG. Between 1975 and 1976 Australia's aid to PNG accounted for 60 per cent of the overall aid budget. Today the 'traditional' PNG country aid program accounts for about 12 per cent of total Official Development Assistance (ODA), and almost 20 per cent including ECP and other ODA-eligible expenditure by other Australian Government departments. It remains the largest of Australia's bilateral aid programs.

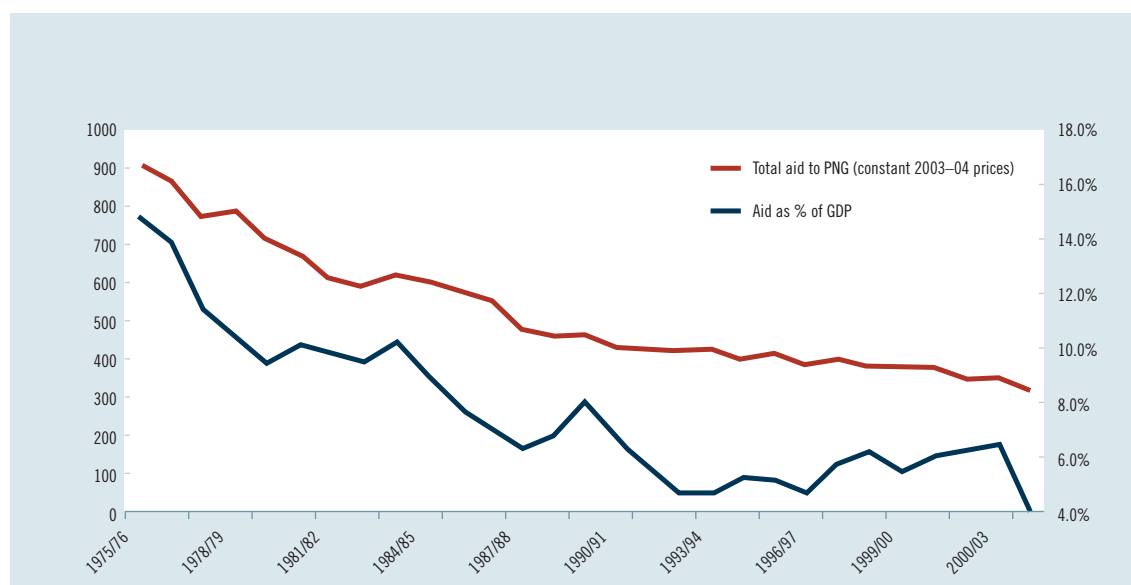
Australia's aid since PNG independence continues a history of engagement going back to before World War Two. Australia's large scale post war involvement in PNG was prompted by a recognition, especially after battles such as Kokoda and Milne Bay, that PNG provides a physical barrier between Australia and Asia, and that PNG's political stability and economic development directly support Australia's national interests and national security. Australia was directly responsible prior to independence for establishing PNG's national infrastructure and

institutions, including roads, schools, health system, justice system, and political boundaries. Major accomplishments included building the Highlands Highway and establishing more than 2,000 health facilities from aid posts to hospitals. In 1970 there were an estimated 55,000 Australian public servants working in PNG, including many in the remotest parts.

The sometimes tenuous sense of PNG national identity is partly due to the fact that nationhood emerged from the peaceful gift of a benign Australian territorial administration rather than principally from PNG's own initiative. Criticisms that Australia did not do enough to prepare PNG for independence should be set in the context of the large real achievements pre-independence, PNG's very low level of development, and the prevailing views of the 1970s about decolonisation and assumptions that financial transfers were the key to development.

Australia consistently has been PNG's largest development partner, providing well over half of PNG's external assistance. Over the years, multilateral agencies such as the World Bank and ADB have been the other major donors. World

Figure 1: Aid to PNG in real terms and as proportion of PNG GDP (1975–2004)



Bank and ADB programs are mainly based around concessional lending, although there has been significant technical assistance support. Japan is a significant bilateral donor, along with the EU.

Australia's aid program has evolved over the past 30 years through several key phases, outlined here.

Budget support

Under Australia's decolonisation obligations to the UN, and perhaps more importantly, because of the close historical and geographic relationship, Australia considered PNG to be a high priority following independence. The Whitlam Government promised A\$500 million as direct budget support over the first three-year period, however this was reduced almost immediately by A\$36 million in the first year.⁵⁵ The budget support policies were continued in 1975 by the newly elected Fraser Coalition government,⁵⁶ which developed the initial five-year aid agreement with PNG from 1976 to 1981. Australian aid was crucially important for the PNG economy at the time of Independence, accounting for 41 per cent of central government's expenditure between 1974 and 75.⁵⁷ In addition, in the immediate post-independence period, a cadre of Australian advisers and specialists from the pre-independence administration still substantially supported the PNG government in a number of areas.

About 60 per cent of Australian aid to PNG since Independence has been provided in the form of untied budget support grants. Assessments of the impact of budget support vary. One view is that budget support contributed significantly to political, economic and social stability after the rapid transition to independence, and helped bridge the resource gap between PNG's high investment requirements and its low domestic savings. It was PNG's preferred form of support, enabling the new nation to set its own development priorities without interference from Australia. It was flexible, easy-to-administer and imposed no debts on PNG.

Analysis of PNG's own funding for different sectors indicates that government funding for key sectors such as infrastructure, health and education was higher when PNG was receiving budget support than in recent times, and contributed (in conjunction with better institutional quality) to the higher levels of service delivery over the 70s and 80s.⁵⁸ The beginning of the transition from budget support to programmed aid coincided with two other significant shocks to the PNG economy—the Bougainville crisis and the devaluation of the kina—and experts working in government in PNG at that time argue the combined revenue shocks resulted in a dramatic decline in operational budgets for service delivery.⁵⁹ Another (largely anecdotal) argument made by some commentators is that withdrawal of budget support over the late 80s and early 90s resulted in a rapid and steep reduction in the number of experienced expatriate advisers contracted by the PNG Government in in-line positions, and that this was a significant contributing factor to the rapid deterioration in institutional capacity in PNG during the 90s.

Other arguments for budget support are that it allowed aid to be spent in conjunction, and aligned, with domestic priorities. It avoided the problem of project aid being implemented outside domestic structures and creating parallel delivery systems that have little domestic ownership, overtax local administrative capacity, are not factored into domestic recurrent budgets, and often have weak sustainability. Another consistent objection to project aid from the PNG Government over the years has been the concern that many of the benefits accrued to Australian suppliers of goods and services—disparagingly referred to as boomerang aid.

The alternative view is that continuing budget support without ongoing policy engagement contributed to the deterioration of the overall budget and resource allocation process. It helped shield PNG from making hard decisions on economic policy and reducing government expenditure, producing a bloated and

55 Dorney, S (2001) *Papua New Guinea Since 1975*, 2nd edition, p 245

56 A revised five-year package of \$180 million per annum was agreed by the Fraser Government, with the proviso that discussions commence on a formula to reduce 'dependence' on this form of aid (eventually agreed at two per cent reduction per annum)

57 Commonwealth of Australia (1975) Budget Paper No 10 'Australia's Overseas Development Assistance 1975-76'

58 AusAID (2003) 'The Contribution of Australian Aid to Papua New Guinea's Development 1975-2000'

59 Eg Jane Thomason, in comments on draft PNG Analytical paper.

unproductive public service and encouraging rent-seeking over-productive investment. According to this view, along with large and poorly accountable resource revenues, budget support helped underwrite the ‘hard kina’ policy, distorting PNG’s exchange rate and depressing agricultural production, which in other developing countries has been the key to broad-based development. Unconditional budget support also limited Australia’s capacity to engage in policy dialogue with the PNG Government. Post-1975, most Australian government departments had little or no dealings with their PNG equivalents, and were not used by Australia to engage in ongoing discussions on policy and economic management issues in PNG and on national development thinking.

Transition to programmed aid

In 1979 the Harries Report into Australia’s relations with developing countries recommended that budget support to PNG be phased out and replaced with project aid having an Australian identity.⁶⁰ In 1980 Sir John Crawford undertook a review of support to PNG and recommended a gradual five per cent reduction in budget support volume to PNG and annual aid level discussions on the mechanics of how ‘supplementary aid’ might function.⁶¹ A second aid agreement, at a planned \$1,300 million for the period 1982–1986, was signed between PNG and Australia based on the Crawford report’s recommendations, but with a slower rate of decline.

In 1984 the Jackson Review of the Australian aid program recommended the phasing out of budget support at five per cent per annum and replacement by training and projects (Jackson noted that at this rate, budget support would still represent more than 50 per cent of the aid program between 2013 and 24). In the subsequent 1985 aid agreement, Australia and PNG agreed on a gradual reduction in the amount of Australian aid funding provided each year of at least three per cent per annum in real terms, combined with a gradual reduction in budget support and an increase in programmed assistance.

The shift towards programmed aid accelerated in 1989 with the signing of the first comprehensive Treaty on Development Cooperation (for a planned ten-year period). Under the Treaty the two countries agreed to shift budget support to programmed aid at a rate of \$37 million a year. The Australian Government’s intent was that budget support would be phased out ‘by 2005 or sooner if that can be achieved’.⁶² A consequence of the relatively rapid shift to programmed aid was that much of AusAID’s effort over the 90s was taken up with the mechanics of programming \$37 million of new expenditure each year. By 1996–97 project aid had grown to nearly \$155 million a year, about half the aid program to PNG. The three priority sectors of education, infrastructure and health continued to receive the bulk of funds (in that order).

The 1997 Simons Review of Australia’s aid endorsed the shift to programmed aid, arguing it allowed more effective targeting of Australian assistance to areas of priority need, in support of PNG’s own development objectives.

Over the 14-year period (1975 to 1989), programmed assistance accounted for only 2.7 per cent of Australian aid funding to PNG. By contrast, programmed assistance accounted for 45.5 per cent of Australian aid funding over the subsequent 14 years (1990 to 2003).

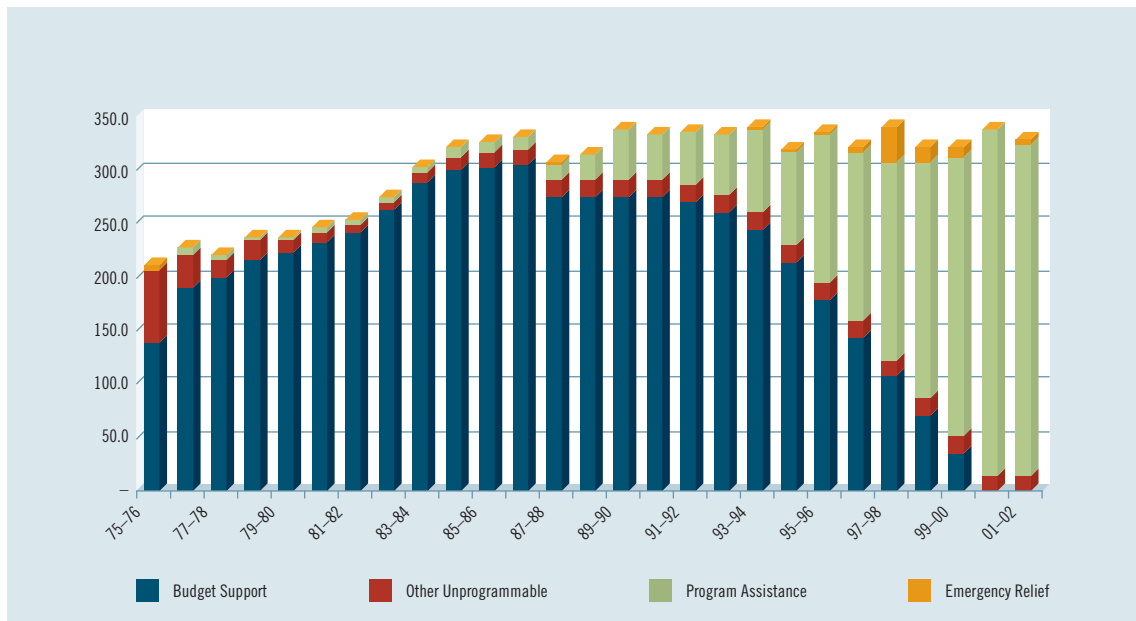
Following the second Aid Treaty review in 1995 both governments agreed to introduce performance benchmarks to monitor the implementation of programmed aid. Benchmarks were developed for health, education and forestry and performance against them was reviewed annually and reported to the annual bilateral Ministerial Forum. In 1997, for the first time, Australia’s aid contribution was incorporated into a ‘new’ development budget for PNG initiated by donors to improved budget transparency and ensure that aid flows are better integrated into PNG’s own development plans. The last budget support payment to PNG was made in 1998–99. Annex A provides a snapshot of changing emphases in aid program priorities in PNG from 1975 to 2000.

60 In AusAID (2004) ‘Australia and Papua New Guinea: Development Cooperation History’ (unpublished)

61 Ibid.

62 AIDAB (1989) Australia’s Development Cooperation with PNG: Submission to the Joint Committee on Foreign Affairs, Defence and Trade Inquiry into Australia’s Relations with Papua New Guinea, p64..

Figure 2: Changes in composition of Australian development assistance 1975–2003



Source: Australia's overseas aid program statistical summary, AusAID, Canberra (various editions)

Impact of programmed aid

An independent evaluation of Australia's aid in 2003 found that it had made a significant contribution to alleviating poverty in PNG, particularly towards improvements of 20 to 50 per cent since Independence in life expectancy, literacy levels, infant mortality rates and school participation rates.⁶³ In terms of programmed aid, it found that Australian aid has been a major influence on PNG's development achievements to date.⁶⁴ Key achievements include:

- > Education: with Australian assistance, the number of children attending school doubled from 510,000 in 1992 to an estimated million in 2002.
- > Health: Over the past 20 years Australia's assistance has helped reduce infant mortality by more than one third and increase life expectancy from 49 to 59 years.
- > Transport: Australian aid has helped ensure that key roads and airports have stayed operational.

3. SPECIFIC CHANGES TO INCREASE DEVELOPMENT EFFECTIVENESS OVER LAST TEN YEARS

Evolution to program approach

As experience with programmed aid improved, there developed a greater understanding of the importance of affordability, of public expenditure management and of the requirement for aid to help build PNG's own capacity to manage and use effectively all its resources, not just aid resources. Over the late 90s AusAID began to shift its programming away from stand-alone projects towards a more integrated sector-based approach, to improve impact and sustainability and reduce the administrative burden on overstretched PNG systems. There was also an increasing realisation that projects were driving parts of the PNG system, especially in line agencies, rather than the program following PNG priorities and helping to strengthen PNG systems and capacity.

63 Ibid, p21

64 Ibid, pp33-49

By the late 1990s AusAID and the National Department of Health had agreed to a SWAp in the health sector, aimed at better aligning Australian and other donor funds in support of the priorities of the PNG health system. From the experience of the health sector, AusAID has since formulated program approaches in the education and law and justice sectors, which also emphasise the principles of building capacity in the counterpart agencies, helping to strengthen policy formulation and priority-setting, and providing technical and financial resources to support implementation.

Increased focus on governance reforms

By 1999 economic mismanagement under the Skate Government, following on from the instability and disinvestment generated by the Sandline crisis in 1997, had taken the PNG economy close to financial collapse.⁶⁵ The PNG parliament responded by electing the Morauta Government following the resignation of Prime Minister Skate.

The Morauta Government and the Structural Adjustment Program

Australia worked closely with the World Bank, International Monetary Fund (IMF), ADB, EU, and Japan (which came to be known as the 'Friends of PNG Group') to support a broad-ranging program of financial, economic and political reform developed by the new Morauta Government. The ambitious reform program became the centrepiece of a major World Bank/IMF SAP implemented between 1999 and 2001. During that period Australia's aid program provided substantial financial and advisory support to help PNG meet its SAP governance reform agenda.

Although the IMF program was successfully completed—a first for PNG—the long-term impact of the SAP reforms was limited. Substantial improvements in economic management between 1999 and 2001 were rapidly undermined by the unleashing of expansionary government expenditure in the run-up to the 2002 national election. Over the medium term, some important governance reforms under the SAP have been sustained,

such as legislation of Central Bank independence, privatisation of the government-run PNG Banking Corporation and reform of the superannuation industry to insulate entities from political interference. Other major SAP reforms, such as the privatisation of other state utilities and reforms to the management of the forestry sector, have floundered. Yet others, in particular the public sector reform process and Constitutional reforms to introduce a more representative voting system and to strengthen the party system, are still works-in-progress.

The key lesson drawn by donors from their engagement with the SAP reform program was the need for a broader and more informed consensus on reform initiatives across the political and bureaucratic spheres in PNG, to ensure greater ownership. Another important lesson was the need for a more gradual, incremental approach to reform that would not overwhelm already fragile institutions.

Over the same period of the late 90s and early 2000s, AusAID's implementation work in service delivery sectors, as well its developing engagement with issues of sub-national governance,⁶⁶ was increasingly highlighting that sectorally focused technical interventions—while important—were not sufficient to improve overall performance. It became clear that without reform of the process of resource allocation in PNG and improvements in the functioning of central agencies critical to it, service delivery could not be improved in a sustainable way.

The Somare Government and the PERR

The combination of the lessons from the Morauta Government's SAP and the continuing need for reform of the resource allocation process and public administration led to engagement on a new reform program under the Somare Government. The new reform process is centred around a PERR program for PNG, developed by the PNG Government with technical support from the World Bank, and a Public Sector Reform Strategy (PSRS) 2003–2007.

Compared to the SAP, the current reform program has a sharper focus on public expenditure

65 Sugden, C (2002) "Correcting Papua New Guinea's costly economic cycles", in Pacific Economic Bulletin 17,2, 2002

66 In particular, AusAID (2000) 'Western Province, PNG: Development Status and Prospects'

management and administrative reforms, and more modest objectives of gradually restoring the functionality of existing systems in PNG. The PERR and PSRS were developed with deeper and broader engagement across the PNG Government's key central agencies than was the case for the SAP public sector reform, which was driven largely by external advisers and the Chief Secretary's department, with limited buy-in from other central agencies. The PERR has brought together the World Bank and ADB, as well as AusAID, in support of the reform plan. Australia's support to date has helped implement important gains in procurement, debt management, civil service retrenchments, and expenditure control.

With donor harmonisation, the World Bank, ADB and Australia actively worked during 2002 and 2003 on the concept of a joint Country Strategy for assistance to PNG, which would form the basis for a joint program addressing priorities at the national, sectoral and provincial levels agreed with PNG. At present, there are a number of operational difficulties with this approach.

Increased focus on security and stability—the Enhanced Cooperation Program

Following the Bali bombing and conflict in the Solomons, Australia's September 2002 Ministerial Aid Statement underlined the links between development and the stability and security of countries in the region. It also re-emphasised the centrality of good governance, especially sound economic management to promote rapid growth and good social policies. Another key message was the need for strong policy coherence between aid and foreign policy and the need for the aid program to coordinate effectively with other Australian government agencies and draw on the expertise available through them.

In line with this new policy approach, in December 2003, Australia and PNG agreed to a bold new initiative to address PNG's growing security challenges and to bolster the existing engagement on budget management and public sector reform through the provision of Australian officials as in-line advisors in key PNG agencies.

The \$1.1 billion, five-year ECP envisaged the placement of up to 210 police with the PNG Royal Constabulary in Port Moresby, Lae, Mt Hagen, Bougainville, and along the Highlands Highway, as well as up to 64 senior Australian officials in key PNG agencies across the legal sector, in economic and public sector administration and in agencies dealing with border and transport security. The key objectives of the program were to address acute law and order problems, strengthen border security, tackle corruption, encourage robust financial and budget management by PNG, and help reform the public service. In terms of approach, a central tenet of the program was to build PNG capacity through the establishment of broad-ranging and long-term relationships between Australian and PNG institutions.

In May 2005 the PNG Supreme Court decided that elements of the Treaty covering the ECP are unconstitutional. The program's future is now subject to negotiation between the Australian and PNG governments.

Increased focus on sub-national governance

Especially since the 1995 decentralisation reforms, core responsibility for delivering many services in PNG rests with provincial and local administrations. But in many provinces, public administration and basic service delivery at the sub-national level are failing due to inequitable funding arrangements between provinces, poor planning and resource allocation, mismanagement within provinces and local government, increasing levels of corruption, and confusion about the roles and responsibilities of different levels of government following the 1995 reforms.

The SNI is AusAID's response to PNG's decentralised system. Built on lessons learnt from implementing sector-wide approaches and from AusAID-supported analytical work on PNG's intergovernmental financing arrangements, the initiative has three objectives:

1. to improve the PNG National Government's ability to support and supervise sub-national levels of government

2. to support sub-national levels of government to meet their service delivery mandates
3. to improve the impact of the aid program by increasing consultation with both levels of government and improving coordination between program sectors.

Specific engagement strategies are being developed for poor performing provinces such as Southern Highlands and for provinces of special interest to Australia such as Bougainville. The program is being trialled in three pilot provinces—Eastern Highlands, East New Britain and Central Province—with full-time budget advisers mobilised to these provinces in October 2004. AusAID will support its management of SNI through co-locating five AusAID staff in the key national Department of Provincial and Local Government Affairs and the provincial administration in each pilot province.

The SNI supports and complements the aid program's work with central agencies to help improve fiscal discipline and ensure appropriate expenditure in key sectors. It is also consistent with the PERR process.

Increased focus on civil society and political participation

Much of the budget management and public sector reform work of recent years necessarily has focussed on the supply side of governance, which emphasises building leadership and management capacity in key central agencies and providing technical support to the reform process. More recently, the aid program has also begun working to strengthen demand for improved governance through:

- > Increased support for churches and non-government organisations to deliver services and to pressure national, provincial and local governments for better service delivery.
- > Support for the media sector, particularly rural radio, to improve access, content and voice.
- > Support for fairer and more representative elections and political representation, including through support for the implementation of PNG's new limited preferential voting system and for voter education to build popular understanding and demand for political accountability.

- > Strengthening oversight and accountability bodies like the Parliament, key Parliamentary Committees (especially the Public Accounts and HIV/AIDS committees), and the National Audit Office and the Ombudsman Commission, which provide avenues for public scrutiny of government functions.

4. OTHER EXTERNAL FACTORS AND PROGRAM RESPONSES OVER THE LAST TEN YEARS

As the volume of available programmed assistance increased during the 1990s, the areas prioritised for Australian support were influenced by drastic changes that occurred in PNG's own circumstances. The program responded effectively to the Rabaul volcano eruptions of 1994, the need to restore peace and provide welfare support on Bougainville, serious drought and frosts in 1997–98, and the devastation caused by the Aitape Tsunami in 1998. The program has also supported PNG to respond to several other natural disasters, including most recently the resettlement of 10,000 people following volcanic activity on Manam Island.

Over the last ten years PNG has faced several fiscal upheavals, in particular the Asian financial crisis of 1997. On several occasions Australia used the aid program to support PNG through fiscal crises by helping to meet some priority PNG Government budget outlays such as contributions to church health services and the school fee subsidy.

The aid program has also played an important catalytic role by sponsoring analytical work on PNG, that has contributed to putting issues such as the threat posed by HIV/AIDs in the public domain.

Some of the major program responses and developments are noted here.

Bougainville peace process and conflict prevention work

Australian assistance has played a key role in bringing peace to Bougainville. Since 1997, more than \$200 million has been provided through the aid program to support the peace process and the province's post-conflict recovery, including the successful conduct of the recent elections

for a Bougainville autonomous government. In particular, AusAID provided \$7 million over five years to support the operation of the Bougainville Peace Monitoring Group, which promoted stability and built confidence in the peace process on Bougainville. The neutral and unarmed group included more than 40 AusAID staff serving as civilian monitors. As the peace process consolidated, in 2003 it ceased operations and was replaced by a small civilian-led Bougainville transition team funded principally by AusAID.

The aid program has also supported conflict prevention measures in the volatile but economically important Southern Highlands province. These included substantial financial support for enhanced security in the 2003 supplementary elections, support for conflict resolution work by local NGOs, the rehabilitation of Mendi High School in partnership with local oil firm Oilsearch, and the development of a conflict vulnerability analysis for the province that will guide future program development.

HIV/AIDS

In 2002 an AusAID-commissioned report—*Potential Impacts of an HIV/AIDS Epidemic in Papua New Guinea*—first raised the alarm about the looming HIV/AIDS crisis facing PNG. The report projected that deaths from HIV/AIDS could reach more than 120,000 per year by 2020 under a worst-case scenario. The economic impact would include reductions in the labour force between 13 and 38 per cent and increases in the budget deficit between nine and 21 per cent by 2020. HIV prevalence in PNG is now approaching two per cent of the adult population, with infection rates increasing annually by 15 to 30 per cent, a pattern similar to that experienced by sub-Saharan Africa. As the epidemic progresses it strains education systems, weakens demand, widens the gender gap, and potentially leads to increased costs across all sectors of the economy. AIDS patients already regularly occupy more than 50 per cent of medical ward beds at Port Moresby General Hospital.

The centrepiece of Australia's response has been the \$60-million National HIV/AIDS Support Project (NHASP), which works with PNG's National AIDS Council. The project commenced in October 2000 and operates in all PNG provinces. With NHASP due to finish in late 2005, AusAID is currently working with the PNG Government and other development partners to develop a new program of support. It seems clear that Australia will need to play a significant role in helping PNG address its emerging HIV/AIDS epidemic, and Australia's International HIV/AIDS Strategy (AusAID 2004) commits AusAID to mainstreaming HIV/AIDS across its development cooperation activities. AusAID's draft HIV/AIDS thematic report concludes that 'an immediate priority should be accorded to elevating the breadth and depth of the response to HIV/AIDS in PNG. (p. 32). The draft report also notes, however, that in PNG, national and provincial AIDS councils have been under resourced and unable to operate effectively, central government leadership has been mixed on HIV/AIDS and there is planning confusion. And for mainstreaming to work finance and planning ministries that control budgets and negotiate the terms of foreign assistance must have HIV/AIDS as a clear priority.

Enclaves or equity report

This 2001 AusAID report helped to highlight the serious social and economic crisis in rural PNG, the risks from projected declines in mineral and oil revenues to 2010 and the need for national economic policy to prioritise investments that would benefit the neglected majority in rural areas. It was a key driver to the development by PNG of a Medium Term Revenue and Expenditure Framework to help guide economic policy.

Incentive fund

An important initiative in 2000 was the establishment of the PNG Incentive Fund to support organisations both within and outside government that demonstrate excellence and financial accountability in delivering community and public services. The program was designed to support reform agents in PNG and to create incentives for performance at an institutional level.

5. EVALUATIONS OF THE PNG AID PROGRAM AND LESSONS LEARNT

Two major external evaluations of the program have been undertaken in recent years— an external rapid impact assessment of Australian aid since Independence undertaken in 2003 and a Joint Aid Review with the PNG Government in 2004. AusAID has also undertaken its own regular evaluative work at project and program levels and further analytical work, on its own and in concert with other donor partners (in particular the World Bank and the ADB). Most recently, this analytical work has started to draw on lessons emerging from recent international research on fragile states. Several common themes emerge in lessons learnt, which are summarised here.

Aid philosophy

There is a need:

- > to have realistic expectations—Australia's aid, while significant, is still only about 20 per cent of PNG's development budget. Aid is also only one element of a broader bilateral relationship. PNG is still a young country with fragile governance
- > for a consistent, long-term approach, working in concert with other development partners
- > to work within existing structures and systems, not duplicate them
- > for the aid program to retain flexibility to respond to emerging requirements, while avoiding stepping in to fund activities for which the PNG Government should accept responsibility. Careful consideration should be given to avoiding distortionary expenditure and substitution of Government of PNG funding by the aid program.

Aid relationship

There is a need:

- > to strengthen the quality of the partnership between Australia and PNG officials working on the aid program through a clearer policy framework, clearer lines of communication between AusAID and Government of PNG with explicit means of resolving differences, and agreed processes of consultation when either

party is considering a significant change in policy or approach

- > for an annual Joint Country Effectiveness Review to monitor strategy performance, to improve both governments' understandings of development perspectives, and enhance the quality of dialogue generally
- > for both governments to share a common view on an appropriate development strategy for PNG if aid funds are to work effectively in concert with PNG's own resources. PNG's expenditure outcomes, as well as the allocation of Australia's aid, must be closely aligned to those agreed priorities
- > to continue to shift from foreign technical assistance to a stronger focus on greater use of local resources. The role of Australian contractors should shift from managing programs to providing credible technical support
- > to move towards a joint strategy approach with the IFIs, other major donors and the PNG Government, to help PNG address its highest priority challenges at central, sectoral and provincial levels.

Development strategy

There is a need:

- > for Australia's development strategy to focus on helping improve the use of *all* resources available to PNG, not just the 20 per cent from donors and the development banks. To achieve this, Australia's aid must support PNG's central agencies to direct and manage coherent budget processes and to provide the leadership for structural reform (which will be gradual)
- > to continue to support policy and management improvements in line agencies in key sectors, and to increase the aid program's focus on provinces by engaging with sub-national governments responsible for delivering most services to the rural majority
- > for the strategic and operational links between the ECP and the rest of the aid program to be strengthened
- > to continue to explore how aid can more strategically leverage change within sectors

and between sectors, central agencies and provinces. Strategies include negotiating on resource allocation, performance-based funding approaches and strengthening core systems of governance.

Emerging priorities from fragile states and other international experience

There is a need:

- > to reprioritise broad-based growth, while continuing to engage on and support governance reforms
- > for a stronger focus on improving rural incomes by facilitating agricultural production and marketing
- > for more emphasis on improving access to information in rural areas, to improve social cohesiveness and to help link producers to market information
- > to maintain service delivery through alternative service providers where state provision has broken down
- > for stronger levels of engagement with local communities, identifying their priorities and targeting their opportunities
- > for greater focus on political economy and analysis of social drivers and constraints to change
- > to re-double efforts to work with Government and other partners to tackle the HIV/AIDs epidemic.

6. CONCLUSIONS

- > Since Independence, Australia's aid program has contributed substantially to overall improvements in health and education and has helped PNG avoid further deterioration in other key sectors.
- > The program responded flexibly and effectively to a wide range of major events that beset PNG, including natural disasters, fiscal crises and the Bougainville conflict, and played a major role in helping PNG overcome these crises.
- > AusAID's analytical work in the early 2000s played a key role in raising the alarm on the looming HIV/AIDS crisis and on the rural crisis facing PNG. The aid program has supported and

underwritten much of the response to the HIV/AIDS epidemic in PNG to date.

- > In recent years the program has evolved rapidly away from stand-alone projects and towards sector-based and program approaches focussed on building PNG policy, management and implementation capacity. The devolution of program management functions to AusAID's Port Moresby office has given strong leadership and purpose to this shift.
- > Particularly over the last five years, the aid program has been heavily involved in governance reform, particularly economic governance, public sector and machinery of government reforms, governance reform at the sector level, and increasingly, political governance.
- > Reform efforts have been bolstered through increasing Australian whole-of-government engagement in PNG, culminating in the ECP.
- > The program has also developed a new initiative to engage on reform of sub-national levels of government, which have primary responsibility for many service delivery functions.
- > Over recent years the program's quality has benefited from devolution and stronger analytical capacity in AusAID, resulting in substantial knowledge gains. Lessons from our own experience in PNG and from international experience especially in fragile states are being effectively integrated into the development of a new Country Strategy.

Evolution of Australian aid objectives in Papua New Guinea

YEAR	CATALYSTS	OBJECTIVES	PRIORITIES
1975	Independence Somare Government emphasis on equity and stability, rather than growth	to assist PNG achieve a smooth transition to Independence and enable it to continue its development strategies in the post-independence period	to enable PNG to set its own development priorities to bridge the resource gap between PNG's high investment requirements and low savings to ensure PNG is able to maintain a stable, viable and united country after its rapid transition to Independence
1980	high expectations for minerals sector Crawford Review	to enable PNG to pursue its economic development policies with assured funding while, at the same time, meeting its stated objective of self-reliance	to reduce budget support gradually and predictably
1982	impact of world recession affects PNG economy, particularly mining sector—fall in gold prices, declining Bougainville copper profits	to provide PNG with a practicable framework in which to plan its development	to ease the rate of decline of budget support
1986	introduction of project aid Wingti Government emphasis on economic growth, away from social services	to accelerate progress towards self-reliance in addition to budget support, to introduce a country program using a range of instruments (projects, training, scholarships, and technical assistance)	revenue generation institution strengthening for key economic departments technical assistance for state enterprises management development in the departments of health, works, police, and justice
1989	First Treaty Namaliu Government increased priority of social sectors	to promote self sustaining economic growth with equity and contribute to PNG's stability and social cohesion to reduce progressively the overall level of Australian aid, shifting from budget support to project aid to maintain support within Australia for aid to PNG to consolidate the geographic spread of Australian aid and achieve an appropriate balance in sectoral emphasis between projects supporting economic growth and those supporting social development	human resource development and institution strengthening, especially at provincial level rural development civil aviation forest and environmental management continued support for law and order projects revenue generation (taxation/customs)
1995	economic recovery program following 1994 financial crisis devolution to provincial governments	to assist PNG meet its objectives of greater self-reliance, economic stability, social and gender equity, and poverty alleviation to strengthen PNG's abilities to develop sectoral policies, improve basic service delivery (especially in rural areas), foster investment, and create employment.	health education and training transport and communication renewable resources law and justice private sector development

YEAR	CATALYSTS	OBJECTIVES	PRIORITIES
1998	recovery from major drought in 1997 restoration of peace on Bougainville	to promote sustainable development, self-reliance, stability, and social cohesion to assist with implementation of PNG's economic reforms to strengthen PNG's ability to improve basic service delivery (especially in rural areas), implement development programs, foster investment, and create employment to enhance PNG's capacity to plan for devolution of service delivery responsibilities to provinces	Same sectors, but emphasis on: maximising involvement of PNG agencies in delivery, including project funding through PNG agencies greater NGO involvement increased commodity supply
2000	Second Treaty budget support phase-out completed	to relieve poverty and achieve sustainable development to introduce contestability among PNG organisations seeking aid funds	strengthen governance improve social indicators build prospects for sustainable economic growth consolidate the peace process in Bougainville

Attachment IV—Exemplar innovations and lessons learned: Executive summary

[Note: This document is a summary of a much larger and more comprehensive analysis of what has worked and why—lessons learnt. That document is available if requested]

This Attachment provides a cursory executive summary of information provided by various sections within the PNG Branch of AusAID in response to requests for information to feed into the AusAID White Paper process. It highlights lessons learnt, innovative approaches, and what has worked in the particular program areas. Not every section addresses all these points. All original documents are included as appendices.

GENERAL OVERVIEW

A major focus of the PNG 2004 Joint Independent Review of the Australia's aid program to PNG was to recommend how to improve aid effectiveness. Key findings include:

- > underlining the importance of good public management to ensure most effective use of PNG's total resource envelope (aid plus PNG's own resources)
- > the importance of constructive engagement between officials of both governments
- > noting that AusAID's good relationships were also an important building block for an effective aid program
- > the need to develop and improved performance framework for the PNG program
- > recognising the importance of the Country Strategy process as a way to improve aid effectiveness
- > underlining the importance of improving donor coordination.

GOVERNANCE

Under governance there are several contributing programs or projects (including the *Sub-National Initiative*, the *Public Expenditure Review Rationalisation* exercise, *Law and Justice*, *Elections* (within Civil Society), and the *Ombudsman Commission*, included further in this summary.

AusAID's experience in governance with PNG's disparate society and culture highlights issues such as the disjuncture between traditional systems and the Westminster model (technical aspects of parliamentary operation are often more important to donors than to local people), weak governance systems, a policy poor environment and consequently poor fiscal management and service delivery (see PERR). The focus of the aid program's current support to the sector is to back genuine reformers in efforts to strengthen existing institutions. AusAID's strong preference is to support existing alliances and PNG-led initiatives.

Successful projects such as the Ombudsman Commission Institutional Strengthening Project (OCISP) have taken account of the need for sufficiently senior leadership and strong performers to progress the issues. At the other end of the scale, the work of civil society and the SNI (see below) in promoting broad demand for good governance is critical.

DONOR COORDINATION

Joint Country Strategy

In response to a generally worsening economic situation in PNG, AusAID, the World Bank, the ADBank and the Government of PNG agreed to devise a JCS for development, which would be a new mode of engagement between PNG and its development partners. The strategy aimed to draw on the comparative strengths of each partner to improve aid effectiveness, through analytical foundational

work, a common strategic framework, and complementary (parallel) programs by each partner. Closer coordination with other development partners was also anticipated.

Although the process was halted, significant lessons were learnt. These included the importance of local ownership, leadership and early participation of all parties, clearly understood expectations from the outset, recognition of comparative advantages, and flexibility to deal with changing country conditions.

The Public Expenditure Review and Rationalisation Exercise: (ANNEX 3)

The PERR is an example of highly successful joint donor coordination, led by the World Bank, between the bank, the Government of PNG, Australia, and the ADB. The PERR exercise helped facilitate a broadly shared understanding among a wide range of stakeholders of what constitutes an appropriately sequenced reform agenda for public expenditure management.

The PERR analysis and process helped, for example, to:

- > frame discussions on issues such as prioritisation of reform agenda
- > develop analytical expertise within the client government
- > increase government interest and enhance ownership of subsequent reforms
- > support understanding of the importance of central agency leadership in improving government effectiveness
- > formulate and coordinate our engagement among a wide range of stakeholders.

AusAID can complement the banks' essential analytical role by engaging at the political level and encouraging follow-up missions by the bank, to keep the reform agenda invigorated. Encouraging the development of a specific diagnostic tool for small fragile states, combining current tools, would also assist engagement and streamlining of processes.

SUB-NATIONAL INITIATIVE

The SNI is an innovative approach, responding to PNG's need for support in delivering services to its people within its decentralised government framework. Its goal is supporting programs and initiatives of the Government of PNG, which focus on sub-national government performance. This is where the primary responsibility lies for financing services such as health, basic education and infrastructure.

The catalyst for the SNI was the failure of the PNG decentralised government system in service delivery. The initiative was developed from lessons learnt while implementing sector-wide approaches, especially in health, acknowledging that sectoral-based programs were comparatively ineffective in an environment of weak governance.

Innovative aspects of SNI include:

- > working from national and provincial government levels, promoting better communication and coordination across government
- > co-locating AusAID staff in key PNG national and provincial government departments, which helps reduce fiduciary risks and contributes to policy and reform agendas. This new management model will be used as a pilot for other program areas
- > using existing funding and funding mechanisms, primarily through the policy stream of the PNG Incentive Fund.

LAW AND JUSTICE

AusAID supports law and justice in PNG through a sector based program. This is both innovative and ambitious. Experience suggests that supporting partner government systems and policies leads to more sustainable improvements in institutional capacity and service delivery. Outcomes, however, rely heavily upon commitment of both the donor and partner governments. It must also be acknowledged that significant improvements can take longer than in traditional donor driven initiatives.

PNG and Australia also recognise that by focussing on sector level objectives, assistance can be targeted to areas with the greatest potential for sustainable

improvements, rather than simply on good performers for the purposes of quick wins. There is now increasing evidence of effective joint responses addressing sector, rather than agency objectives, and a decreasing reliance on donors.

CIVIL SOCIETY

AusAID's long-standing experience in working with civil society in PNG has highlighted the central importance of local ownership and participation at all stages of projects and programs. This can be ensured by supporting visions that emerge from the community, or can be generated through participatory approaches and community contributions. Without such considerations and approaches, conflict can be created or exacerbated and projects are less likely to be successful or sustainable.

These lessons have led to innovative and differing partnership approaches such as the Media for Development Initiative and the Church Partnership Program (Annex 6). There is focus on dialogue, joint decision making, facilitation of relationships, and consultation, all of which promote local ownership, interest and sustainability.

Elections

Within the Civil Society Program, AusAID supports improvements in the PNG electoral system. The focus is on building a stronger community constituency and demand for better governance. Lasting reforms are likely to take time and need longer term engagement. A partnership between the PNG Electoral Commission and civil society groups may be important for overcoming challenges in some locations of electoral malpractice (Annex 6).

Infrastructure

A key challenge with PNG infrastructure was finding ways to link road maintenance expenditure to public sector reform and budget management. Through PERR and discussions with PNG, AusAID and the Government of PNG, on the economic value of roads, an innovative solution emerged, linking the public sector redundancy program with funding needed for road maintenance. That AusAID was

involved in initiating activities on different fronts helped open up the opportunity for such linkages.

Health sector

Over the last five years or so, the PNG National Department of Health (NDOH) has led the development of a new means of working in the health sector, called a Sector Wide Approach (SWAp), named the Health Sector Improvement Program (HSIP). In many ways this is able to support and build upon broader reform efforts the NDOH is pursuing within the sector.

Taking a sector-wide approach emphasises donor coordination and allows the NDOH to demonstrate and develop leadership and organisational capacities. However, in moving from a project approach to a SWAp, there is increased focus on, and engagement with, the National Government through contractors. There are risks of neglecting NGO/Church engagement, or increasing the separation between AusAID and the Government and contractors. Funding must be considered. There are elements within the SWAp which contribute to a focus on strengthening and supporting areas such as transparency, accountability, and priority setting of Government of PNG.

Within the Health SWAp AusAID has been developing a new health activity called the Capacity Building Service Centre (CBSC), due to commence its inception phase in August 2005. This will include embedding TA with Government of PNG, using Government of PNG funding sources and taking a partnering approach to contracts.

Bougainville

Australia's aid program to Bougainville has taken a new direction since late 2003. The *Framework for Australian Aid Assistance to Bougainville 2004–2008* reflects a more forward looking and strategic approach than the previous approach of responding to the crisis situation. The key objectives of the framework are:

- > assisting with the implementation of autonomy and public sector reform
- > improving essential service delivery
- > promoting economic growth.

The Governance and Implementation Fund (GIF) is an innovative approach to financing this support. The GIF is aimed at improving public expenditure management, local decision making, better donor coordination, promoting accountability, and public sector reform. Through the GIF priorities are determined by the Bougainville Government and agreed to by donor partners. Contributions are performance based, in line with improvements in key governance areas.

Achievements and lessons learned in the first 18 months of GIF's operation include:

- > without the GIF, progress towards autonomy would not have advanced
- > Government of PNG and Bougainville leaders have been brought together
- > it has helped re-establish knowledge and use of appropriate Government of PNG financial systems and practices, and increase confidence in budget planning
- > increased confidence in planning, knowing the resource envelope
- > for AusAID it has reduced ad hoc requests for aid, allowing better targeting, and increased engagement, but it is heavily reliant on TA and AusAID staff time
- > other donors have been reluctant to contribute without direct attribution being made
- > the approach has taken time to evolve and must be understood as long-term in nature.

Glossary

ADB	Asian Development Bank
ASPI	Australian Strategic Policy Institute
CACC	Central Agencies Coordinating Committee
CIE	Centre for International Economics
DAC	Development Assistance Committee
DFID	United Kingdom's Department for International Development
DPLGA	Department of Provincial and Local Government Affairs
DRIP	District Roads Improvement Program
ECP	Enhanced Cooperation Program
EU	European Union
GIF	Governance and Implementation Fund
HSIP	Health Sector Improvement Program
IMF	International Monetary Fund
JBIC	Japanese Bank for International Cooperation
JCS	Joint Country Strategy
JICA	Japan International Cooperation Agency
LICUS	Low Income Country Under Stress
MDG	Millennium Development Goals
MP	Minister of Parliament
MTDS	Medium Term Development Strategy 2005-2010
NDOH	National Department of Health
NEC	National Executive Council
NEFC	National Economic and Fiscal Commission
NHASP	National HIV/AIDS Support Project (NHASP)
NIP	National Indicative Program
NPRS	National Poverty Reduction Strategy
OCISP	Ombudsman Commission Institutional Strengthening Project
ODA	Official Development Assistance
PERR	Public Expenditure Review and Rationalisation
PNG	Papua New Guinea

PPII	Provincial Performance Improvement Initiative
PSRS	Public Sector Reform Strategy
SAP	Structural Adjustment Program
SNI	Sub-National Initiative
SWAp	Sector Wide Approach
TDC	Treaty on Development Cooperation
TRIPS	Transport Infrastructure Priorities Study



Australian Government
AusAID

10

Engaging the Australian Community

Analytical report for the White Paper on
Australia's aid program

Prepared by
Gaye Hart and Ellen Shipley

OCTOBER 2005

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Executive summary

1. To date, the Australian Government's engagement with the Australian community has been primarily through its relationship with program implementers, particularly development contractors and Non-Government Organisations (NGOs). The more recent whole-of-government approach to development has expanded involvement in aid delivery by other organisations, including Australian, state and local government agencies.

2. Participation in the White Paper process included targeted seminars and consultations. It involved think tanks, the corporate sector, sectoral specialists, and civil society, and confirmed there is an extensive community of interest in overseas development, beyond traditional development partners.

3. New directions for Australia's aid program may identify gaps in the level of expertise and experience of those delivering services and point to the need for new partners. There may also be new and innovative ways in which existing development practitioners can work together. Given the long history of Australian community engagement in the aid program, it is likely that future partners are already known in the development community and possibly engaged in development in the region, although not necessarily directly involved with AusAID.

4. In seeking to enhance capacity to deliver strategic development outcomes, the aid program must move beyond dealing with Australian partners—current and potential—only as implementers and develop

new approaches that build on, and leverage off, the extensive development knowledge and capability that exists within the Australian development community.

5. A concerted effort is needed to capture knowledge and experience and share the learning of development practitioners. This requires investment in infrastructure—to support knowledge management—and also an openness and sustained commitment to seeking new ideas. A more active approach to community engagement also implies placing value on Australian practitioner knowledge, welcoming contestability of ideas and engaging with critical thinking.

6. There is a high level of congruence between the interests of the Australian public in reducing poverty and the current direction of the aid program. However, there is a need for a communication strategy that improves the level of understanding by the Australian public about the new approaches to aid delivery being adopted by the Government. Extended community engagement needs to be supported by a refocused and proactive public affairs strategy with sufficient flexibility and resources to support the evolving aid framework and engagement with both existing and new players.

7. Effective ongoing community engagement presents considerable challenges. It requires leadership and strategic decision making by AusAID to determine the priorities for engagement, and sustained commitment to relationship-building.

It should be accompanied by a clear message that the aid program cannot be all things to all people. It must remain focused on long-term, strategic development outcomes.

8. This paper identifies opportunities for more effective engagement with the Australian community. It recommends establishment of a three year Community Engagement Program, specifically focussed on maximising the expertise and experience offered by its various partners; identifying new partners with skills relevant to new and emerging development issues, and sustaining high public support for the aid program.

PROCESS

9. The Australian aid program has been subject to extensive review three times in the last 20 years. The Jackson Review (1984), the Simons Review (1996) and this current White Paper have all been broad-ranging in their community engagement. The White Paper, in its search for input to the ‘medium term strategic blueprint for the Australian aid program in the Asia Pacific region’ has demonstrated a new and expanded level of community engagement on thematic, country and process issues.

10. Consultation with targeted thematic groups, experts, representatives of the media, parliamentarians, the corporate sector, community based organisations, think tanks, and longstanding partners in development has brought a broader perspective to the debate. This process suggests a high level of congruence between the interests of the Australian public in reducing poverty and the current direction of the aid program.

11. This paper is based on a desktop audit and review of current Australian Government engagement with the Australian community; research and analysis of relevant publications and policy documents; and consultation with Australian participants in the aid program. The Australian public has participated through four Town Hall meetings (Brisbane, Melbourne, Perth and Sydney) convened by the Parliamentary Secretary for Foreign Affairs. See Attachment A

12. The consultation process confirmed that the term ‘community’ is, as it often described, ‘a nebulous and difficult concept’ (Winter *et al.*, p.16). It is generally used to refer to a group of people who share something in common, be that location, interest, culture, language, values or tradition. The word community is used here to encompass the broad range of active interest and participation in Australia’s overseas development program.

13. Not all people or organisations that might be considered participants in the development community are directly engaged with the Australian Government’s aid program. Within this notional development community individuals and organisations can be members of many communities and wear a variety of hats. (Adams, 2005) In this paper, the development community is distinguished from the broader population of the Australian public which has a significant, but less active, interest in the aid program.

14. The words ‘partnership’ and ‘community engagement’ are part of the development lexicon. The words are often used interchangeably within the development community to refer to almost any interaction with the Australian public, service deliverers or recipient countries. Generally, this terminology is used without specific definition and to acknowledge that effective relationships between the Australian Governments, the general public and key groups in the development community are critical to achieving the goals and objectives of the aid program.

WHY COMMUNITY ENGAGEMENT?

15. The groundwork for the changes in the way the aid program is managed and delivered was laid out in the 2005 Ministerial Statement *Australian Aid: An Integrated Approach*. The key changes have been:

- > a sharper focus, both financially and intellectually, on our immediate region and on governance
- > a more robust Australian Government approach including increased engagement by key agencies
- > a stronger policy framework backed up by a commitment to implementation
- > changes in managing the aid program (13th Annual Statement to Parliament).

16. The Government relies on the Australian community to inform and implement its aid program. The Government also recognises that effective partnerships with key groups will be critical to achieving the program's medium-term goals and objectives.

17. While public support for overseas aid is relatively high in Australia, the Government is mindful that scrutiny of aid has increased as aid budgets have increased, and that the recent public response to the Tsunami is accompanied by a heightened demand for accountability.

18. The question posed in the *Guide to the Core Group* is: 'How should Australia's aid instruments, approaches and partnerships evolve to effectively deliver on its medium term strategic outlook?'

19. Strengthening the relationship between the aid program and the Australian community should be purposeful and strategically managed, to support the two primary objectives of community engagement:

- > to enhance Australian Government capacity to deliver strategic development outcomes
- > to increase public understanding of the Australian aid program.

20. The following sections identify existing patterns of engagement and focus specifically on how institutional, academic, people-to-people, and community links can be engaged more effectively to facilitate and enhance the aid program.

EXISTING STRUCTURES FOR COMMUNITY ENGAGEMENT

21. Bilateral or government-to-government aid makes up the bulk of the aid program. Within Australia, there are two main avenues for community engagement—service delivery and public information.

22. Australian service delivery has been primarily through Australian private sector contractors and NGOs. The main means of engagement with Australian partners has been through various contracting and funding mechanisms used to engage them in service delivery. This relationship is supported by consultations, other forums and information sharing activities which involve technical experts, public sector institutions, universities, research institutions, private sector international development firms, and NGOs. Attachment B outlines the mechanisms which currently exist to engage the broad Australian community.

23. The Australian aid program draws upon the many areas of comparative expertise in Australia, 'whether that involves financial management, agricultural research or Human Immunodeficiency Virus (HIV) responses. The government also fosters integration between different sources of aid personnel, particularly volunteers, youth ambassadors and NGOs with bilateral programs, to strengthen the focus of our efforts and make more cost effective use of resources' (2002 Statement, p. 60).

24. In recent times the Australian aid program has played an important role in the whole-of-government responses to issues in our region of trade, environment, immigration, conflict, and transboundary issues such as disease, drugs and crime. This has brought with it an increased role for the Australian Public Service in policy development for and delivery of the aid program, as another area of comparative expertise.

25. The Australian Government is committed to 'ensuring that the community is informed about and supportive of the aid program' (2002 Statement, p. 61). The public is informed about the Government's aid program through a comprehensive public affairs strategy which seeks to 'ensure high quality, effective participative communication with the public and stakeholders.'

ENGAGEMENT WITH DEVELOPMENT CONTRACTORS

26. The Australian Government's current engagement with the private sector in relation to overseas development is almost entirely with development contracting companies involved in implementing the aid program.

27. A significant proportion of the program is delivered by a relatively small number of Australian and New Zealand players. The top ten contractors to AusAID account for 65 per cent of contracts by value. This appears to reflect the impact of larger and fewer activities, and the capacity of larger firms to meet aid program requirements for financial securities.

28. Development contractors claim to bring a wealth of delivery experience and knowledge to the aid program. For example, international development company ACIL has 35 years experience in international development and managed more than 400 projects funded by AusAID, World Bank and the Asian Development Bank (ADB) in 63 countries including countries in Asia, Papua New Guinea (PNG), the Pacific, Africa, the Middle East, and the Caribbean (ACIL Presentation on Development, 6 April 2005). Many other contractors indicate similar experience and capability.

29. While partial untying of the aid program has increased competition between contracting firms, it appears also to have created a degree of fluidity as various contracting companies merge or are subsumed to form larger companies. At the same time, there is widespread support for further untying of commercial contracts, to encourage internationally competitive tendering. Most development contractors believe they are competitive and ready for such a move.

30. While there have been some new entrants to the market place in recent years such as Deacons, it is considered relatively difficult for a new contracting company to enter the market place. Some relatively new players described the aid program as a 'closed shop'. The difficulties were variously attributed to a perceived 'lack of invited interaction', the challenges posed by the 'regulatory and administrative regime', and the large up-front financial commitment. These assertions will need to be addressed in order to attract new players.

31. The small-to-medium size of the largest Australian aid consulting firms limits their ability to dedicate resources to research or policy analysis. However, during the consultations it became evident that there is a wish by both AusAID and the contracting firms for knowledge sharing and dialogue on development policy issues. In contrast, it seems that the main thrust of dialogue between AusAID and the contractors in recent years has been about tendering, implementation and performance issues.

32. The Development Contractors Forum is an opportunity for engagement but it tends to focus on the nuts and bolts of the program. Consequently, engagement between the key firms and AusAID remains caught in the details of the activity mindset. This focus is understandable. The tender process is considered strict and rigorous and in 2004–05, the aid program let 1 300 new contracts with an approximate value of \$812 million. Nevertheless, this focus appears to detract from opportunities for knowledge sharing and diminish the opportunities to learn from experience.

33. The development contractors indicated a willingness to collaborate with other players in delivering the aid program. They are often experienced in working with the multilaterals and the UN system and at working with carefully selected agents and local representatives. There are increasing examples of collaboration between development contractors and NGOs, to extend development impact and to achieve mutually compatible goals. Anecdotally, the development contractors and NGOs ascribe high levels of success to these collaborative efforts, despite the difficulties in bringing together staff from differently structured organisations.

34. Breaking down the silos in which AusAID engages with its partners and bringing practitioners, experts, researchers, and others together in high-level thematically focused forums would encourage sharing of knowledge and experience, contestability of ideas and input to policy development. It is also suggested that incentives for documenting learning in the field would encourage contribution to development related research by development contractors.

35. Commercial contracts should be further untied, to encourage internationally competitive tendering.

ENGAGEMENT WITH NON-GOVERNMENT ORGANISATIONS

36. The Australian Government and development NGOs have worked together for many years to implement Australia's aid program. The Government recognises that 'NGOs play a valuable role in the delivery of Australian aid. In particular, their strengths in garnering public support for the aid program, developing links with communities in developing countries, and flexibility in working in difficult environments' (11th Annual Statement to Parliament p. 58).

37. NGOs also believe that their contribution, while relatively small in relation to the total bilateral program, plays an important niche role in supporting the aid program. NGOs see themselves as:

- > well positioned to respond to humanitarian crises and rapidly able to deploy people who are experienced in humanitarian and emergency relief work
- > able to harness the Australian public support for development assistance
- > able to work effectively, on a people-to-people basis with poor communities in developing countries
- > sometimes able to work outside a bilateral context, such as in Burma, where there is no government-to-government aid program
- > able to work with civil society to facilitate demand-led governance.

38. Less than ten per cent of the Government's funded aid program is implemented by NGOs. Government funding comprises around 15 per cent of the total funds managed by the NGO sector. More than one million Australians claim to give their time or money to overseas aid each year. Financial support from the Australian public has grown at about 12 per cent per annum (excluding Tsunami fund raising) and continues to provide the largest proportion of funds for overseas work undertaken by Australian NGOs.

39. The effectiveness of NGO work relative to bilateral aid is subject to ongoing debate. The significant difference is one of scale. Most of the research into the effectiveness of foreign aid

has been in response to macroeconomic inputs. Evaluations of NGO aid have been conducted mainly at the project level and there is very little hard evidence on which to base scaling-up proposals. Nevertheless, a recent International Monetary Fund (IMF) Working Paper (Masud & Yontcheva, 2005) shows that while NGO aid reduces infant mortality and does so more effectively than official bilateral aid, the impact on illiteracy is less significant. Masud and Yontcheva also test whether foreign aid reduces recipient government efforts in achieving development goals and while finding some evidence of a substitution effect between bilateral aid public sector expenditures, conclude that NGO aid does not affect social spending in the recipient country.

ACCREDITATION AND ACCOUNTABILITY

40. There are currently 122 NGOs eligible to give tax deductions for donations to their overseas aid programs. Forty four organisations are accredited to receive AusAID funding through the AusAID-NGO Cooperation Program (ANCP). The ANCP and accreditation (the process by which Australian NGOs gain access to funding from ANCP) demonstrate the long-term relationship between the aid program and development NGOs in Australia. ANCP and accreditation are unique to the Australian aid program and should be maintained.

41. The Committee for Development Cooperation (CDC), established in 1975, is a joint AusAID/NGO advisory and consultative body whose functions relate to accreditation and the development of policy to underpin the ANCP. In previous years, the CDC considered both funding and broader aid policy and was the main interface between the Government and NGOs interested in overseas development. The role of the CDC is under review and it is expected it will be reduced in size and its mandate confined to accreditation and ANCP.

42. As international NGOs and other civil society organisations 'have become increasingly visible and influential actors in national and international arenas on issues such as sustainable development, human rights, environmental preservation and economic justice questions have been raised about accountability' (Brown, Moore & Honan, 2004,

p. 31). The Australian Code of Conduct is highly regarded internationally and is seen as a practical manifestation of the challenge facing all NGOs world wide 'to show that they can put into practice the [accountability] principles that they campaign for on others' (Edwards, 2000).

43. The Australian Council for International Development (ACFID), the peak industry association representing some 80 NGOs, is committed to aid effectiveness and to accountability and has cooperated with the Australian Government to institute a rigorous approach to assessing NGO capability and evaluation of performance. Strengthened AusAID accreditation criteria and processes, together with the standards of governance, organisational integrity, finances, communication, and management practices demanded by the ACFID Code of Conduct, demonstrate a high level of shared commitment to continual improvement in development standards and to openness and transparency in reporting.

44. While NGOs also claim that their values base is a critical factor in discussing NGO accountability and performance, this does not lessen the fact that scrutiny of their accountability is right and proper. Accountability has been described as 'primarily about securing a level of confidence and trust in an organisation's legitimacy' (Stewart-Weeks 2003). It is essential, and in the mutual interest of the Government and NGOs, to collaborate on matters of accountability as a contribution to maintaining public credibility. This approach has been effectively demonstrated in the joint Tsunami reporting.

POLICY DIALOGUE

45. NGOs also engage with the official aid program through meetings, workshops and forums. These include broad policy dialogue between AusAID and ACFID, high level discussions at the CEO level, and country- or issue-specific discussions with relevant accredited NGOs. In terms of policy dialogue this is sometimes effective and sometimes submerged in contractual and administrative consideration.

46. ACFID seeks to be strategic in its contribution to the policy debate and, like the development contractors, claims to have a wealth of practitioner

knowledge to bring to the table. However, the NGO capacity to document the action learning that takes place in the field is similarly limited and, without systematic and long-term data capture and analysis, field experience does necessarily or readily translate into policy.

47. On the other hand, the fairly recent ACFID research on development effectiveness which identified a series of field based standards for practice has the potential to contribute to development practice (Roche & Kelly 2003). It is important that this work be subject to further field validation and the findings captured and debated as a contribution to lessons learned.

48. In the current dialogue between NGOs and AusAID on policy matters there seems to be little middle ground between development advocacy on the one hand, and examples of grassroots development practice on the other. While some of the larger internationally based member organisations, such as World Vision, Care Australia and Oxfam do have some capacity for research and policy analysis, ACFID is limited in its ability to engage at the high level required for substantive discussion and robust debate in policy dialogue because of its lack of research capacity.

49. ACFID seeks to represent the views and interests of its heterogeneous membership to Government and other key stakeholders and in doing so, seeks to influence government policy. At the same time, it is engaged by AusAID on a fee-for-service basis in relation to AusAID-NGO cooperation and representation issues, statistical survey data and the Code of Conduct. The twofold nature of this relationship between ACFID and the international aid agency is bound to result in some tension.

50. As the aid program responds to changes both within the broader development context and the region, it is timely for AusAID and ACFID to reconsider their relationship with a view to engaging in more productive and mutually effective ways that enhance policy dialogue and contribute to aid effectiveness. It is proposed that AusAID and ACFID cooperate in long-term empirical research aimed at confirming the Australian NGOs' claims

of effectiveness with a view to scaling up where appropriate.

51. **The Australian Government should reaffirm the importance of ANCP and Accreditation as the primary tools for engaging with Australian professional development NGOs.**

VOLUNTEERS

52. The aid program has a significant engagement with the Australian community through the Australian Volunteer Program. *Volunteers and Australian Development Cooperation*, the aid program's 2004 volunteer policy statement notes 'Volunteers are catalysts for ongoing sustainable linkages and partnerships between organisations and communities in Australia and partner countries. Effective volunteer-based partnerships can foster integrated approaches to strengthening organisations in developing countries and can take many forms: networks, knowledge-sharing and linkages with Australian organisations.' (p.3) The *Guide to the Core Group* maintains that 'the growth in volunteering amongst all ages of the population is one of the most practical and substantive avenues for growing Australian understanding of aid and development issues'.

53. There are more than 27, 000 volunteers contributing their time to ACFID member agencies through membership, boards and governing bodies, campaign or education work, and as office volunteers. In addition there were 4,600 Australians work overseas with Australian NGOs in 2004-2005, many of them engaged through an Australian Government supported volunteer program (ACFID Annual Report, 2004-2005). The Government supported Australian Volunteer Program comprises the Australian Youth Ambassadors for Development (AYAD) program and a core program which features Australian Volunteers International (AVI), Australian Business Volunteers (ABV) and Volunteers for International Development from Australia (VIDA).

54. Volunteer engagement in the aid program extends well beyond the individual volunteer. The Australian Volunteer Program also provides opportunities for Australian organisations of every kind to participate in development. Australian

organisations can use the volunteer program to generate or extend their own links to organisations overseas by developing a volunteer assignment, identifying an opportunity for a member of staff to volunteer and/or supporting community based volunteer organisations.

55. Community participants at the Town Hall meetings recommended developing a framework to coordinate Australian industry, NGOs and volunteers to create closer links and greater synergies between development participants (White Paper Forums, Summary of Public Input, www.ausaid.gov.au).

56. Volunteering is not only a tool of aid delivery, it is also one of the most visible means of community engagement. It provides opportunities for the young to participate in development, and uses the skills and experience of older people including families. Volunteers contribute to development and bring a vital and unique community experience to their development work and to their home community in Australia on their return.

57. **Support for volunteering should continue, as volunteering is a valuable form of community engagement. Moves to increase the volunteer program should be considered in light of the White Paper and recent increases, such as doubling of the Australian Youth Ambassadors for Development Program and increased funding to the Australian Volunteer Program.**

COMMUNITY BASED ORGANISATIONS (CBOS)

58. Partnership arrangements and networks within the development community have evolved over many years. Today, there is extensive civil society interest, beyond the traditional development community, in engaging with the aid program. There have been calls to extend civil society engagement through Community Based Organisations such as Rotary, Lions, professional and specialist groups (such as medical practitioners) and local government organisations.

59. The PNG Church Partnership Program (CPP) is an innovative approach to building the relationship with existing partners, by expanding engagement with the local church partners of faith-

based development NGOs. This is consistent with calls during Town Hall meetings for increased engagement with community groups and NGOs, including churches, in development work and the facilitation of community-to-community engagement (White Paper Forums, Summary of Public Input, www.ausaid.gov.au).

60. CBOs may participate in the Australian Volunteer Program and many already work with a diverse range of organisations including national and international NGOs, churches and academic institutions. However it is evident that they are seeking additional opportunities to participate more actively in implementation of the aid program. While usual contracting processes offer solutions for purchasing services from specialist groups, existing mechanisms for both funding and consultation can exclude CBOs and other specialist groups.

61. To date, AusAID has engaged with CBOs on a fairly ad hoc basis based on themes or sectors of relevance to the aid program (such as HIV/AIDS), or when driven by a specific event, like the Tsunami. These themes and events can create an interest among CBOs who normally have a domestic Australian focus, or who may implement activities internationally, but without government aid funding. The strength of CBOs appears to be in their belief that they have something of value to offer to overseas development, and in their people-to-people contact.

62. A distinction needs to be made between more formally established CBOs who have experience in-country on development issues and interested individuals and loosely associated groups who may be identified as a CBO. The former may well have development experience that complements the aid program. The latter's experience is frequently through people-to-people services based on personal or professional contacts, which, while important, do not necessarily contribute to the long-term development objectives of the aid program. Sometimes this individual interest is manifested in offers to donate goods or services, particularly in times of crisis.

63. If service delivery partnership opportunities are extended to CBOs, then new and different rules of engagement will be needed. Such arrangements,

while more flexible, must also have sufficient provision for accountability to provide a level of confidence in an organisation's capacity to contribute to the specified and agreed development outcomes. Such mechanisms should not be introduced simply as opportunities to fund good intentions and good ideas. Shared accountability and commitment to long-term development effectiveness is a prized asset. It contributes to the high levels of community support for the aid program and should not be compromised.

64. Rather than seeking to include the full range of these CBOs in the aid program, it may be more efficient to put them in contact with other organisations active in service delivery through a brokering facility. This could be similar in concept to the Industry Capability Network, which facilitates business partnerships for the purpose of local supply, access to global supply chains and local business growth. Another alternative would be to better promote the Direct Aid Program and Small Activities Schemes that operate at Diplomatic Missions, with a view to enabling the local counterpart of an Australian group to apply for assistance. Given the number of approaches to AusAID, consideration needs to be given to establishing a cost effective process to evaluate ideas and offers of goods or services. To avoid raising expectations there will need to be absolute clarity about how far the door is open.

ENGAGEMENT WITH THE CORPORATE SECTOR

65. The business community is keenly aware that a stable, prosperous and secure region is important for business investment. Private sector investment has a major impact on the prospects for ending poverty and a number of Australian based companies have operations in Asia and the Pacific that might well be described as having a development component. It appears that AusAID has had little direct involvement with the corporate sector, although recently AusAID has strengthened its engagement with the corporate sector on HIV/AIDS prevention activities in the region.

66. The *Guide for the Core Group* refers to 'a strong international consensus that broad based economic growth is central to reducing poverty'. Consistent

with other donors, the Australian aid program, particularly in recent years, has concentrated on improving the environment for private sector development. The corporate sector, particularly companies with investment interests in Asia and the Pacific, should be encouraged to take a more active role in identifying ways to generate investment and growth in the region.

67. Corporate Responsibility (CR) reporting has been increasing since the early 1990s and has expanded from purely environmental reporting to include social and economic sustainability. The KPMG 2005 International Survey of Corporate Responsibility Reporting confirmed that CR reporting in industrial countries has clearly entered mainstream reporting. The Global Reporting Initiative (GRI) has developed a guide to help businesses assess and report on how their activities are contributing to the development of the Millennium Development Goals (MDGs). Some 40 Australian organisations are identified as using the GRI tool, including BHP Billiton, Visy, Westpac, and Western Mining Corporation Resources Ltd.

68. The Prime Minister's Community Business Partnerships (PMCBP) program recognises that 'just as they have always needed to run their affairs in a fiscally responsible way in order to remain viable, many businesses now believe that they need to take into account social, economical and environmental impacts to remain sustainable into the future' (PMCBP website, www.partnerships.gov.au).

69. Development NGOs have shown considerable initiative in building relationships with the corporate sector. In the past NGO and corporate sector partnerships focused mainly on fund raising. One of the most successful partnerships is the Qantas/UNICEF Australia Change for Good program which has raised more than \$10 million since its inception in 1991 and also communicates a development message to thousands of airline passengers each week. NGOs are now moving beyond fundraising activities in their relationships with the corporate sector and giving greater attention to 'knowing better how business works so that we

can work effectively with them'. This approach is seemingly motivated by efforts to adapt to a rapidly changing world in which the private sector now accounts for the bulk of investment in developing countries.

70. As one example, Oxfam Australia recognises that the private sector, operating on the basis of market forces, is the most important source of economic growth in almost all developing countries. In support of this approach Oxfam Australia has established the Corporate Community Leadership Program which in recent years has taken senior BHP Billiton and Newmont executives to India 'to improve the company's capacity to respect the rights and enhance the livelihood of communities it works with around the world'. Oxfam asserts that 'poorly designed or regulated private sector investment can further marginalise and impoverish the poor' and identifies its role as 'working with the corporate sector to find policies and practices which benefit both the corporations and their host countries and their people' (Oxfam News 2003).

71. All member countries of the International Mining Council (IMC) have signed up to the MDGs as part of their commitment to sustainable development. The Mining Council has called for a 'more coordinated approach between governments, industry and international agencies' to ensure that mining investments foster both economic and social development (Mitchell, 2005). While suggesting that 'There are some NGOs with which a dialogue about how to put in place world's best practice social and community sustainability strategies is a waste of time', Barns (2005) identifies Oxfam Australia, with its mining ombudsman process and code of conduct for Australian mining companies overseas, as having 'the skills and networks throughout the world that can help companies to avoid the pitfalls of being caught up, wittingly or unwittingly, in civil unrest'. Clearly not all NGOs are inclined to, or capable of working with, the corporate sector at this level.

72. As a matter of priority, AusAID should identify and engage with companies with investment

interests in the region with a view to creating partnerships and alliances that strengthen development outcomes. Other opportunities for engaging with the corporate sector include working through the PMCBP to encourage CR reporting by Australian based companies with operations in Asia and the Pacific; giving profile to improved engagement with the corporate sector by creating an overseas development award linked to the Prime Minister's Community Business Partnerships; and supporting NGO efforts to work effectively with the corporate sector towards a shared understanding of sustainable development.

ENGAGEMENT WITH THE PUBLIC SECTOR

73. As well as whole-of-government initiatives referred to previously, the aid program draws upon federal, state, territory, and local governments for specialised skills. Programs such as the Public Sector Linkages Program (PSLP)—\$8 million in 2005-06—have encouraged relationships between public sector institutions at federal and state and territory levels, and the program was recently expanded to include public universities.

74. Public sector linkages have been encouraged at the state, territory and local government levels, in the interests of aligning government service delivery to an appropriate and affordable level for developing country governments. For example, the Local Government Partnerships Program in PNG (2002-06) aims to facilitate and promote the effective, responsive and accountable delivery of local services, especially to poor and disadvantaged groups. The program supports sustainable partnerships between individual local authorities. This model may be useful in other country programs to support such linkages.

75. The *White Paper Roundtable with Parliamentarians* reinforced the notion of 'right sizing' technical assistance for improved development outcomes. Public and private sector collaboration is evident at different levels, reflecting these calls for right sizing. An example is the collaboration between development contractors and government authorities such as Snowy Mountains Engineering Corporation and Hunter Water in the Solomon Islands.

76. The aid program should expand its efforts to engage with state, territory, and local governments to identify appropriate partners. The aid program could benefit from coordinated and ongoing linkages to state organisations such as the Queensland International Aid and Development Business Unit, as well as other state departments and agencies. Current engagement with the Australian Local Government Association (ALGA) should be continued and strengthened. Consideration should also be given to expanding the PSLP to other public sector organisations such as public hospitals.

ENGAGEMENT WITH UNIVERSITIES AND RESEARCH INSTITUTIONS

77. AusAID has substantial and long-term linkages with universities and others doing development related research in Australia and overseas. AusAID engagement with key research centres and collaborative research networks is strengthened through research partnerships on topics of strategic importance to Australia's development cooperation program such as with the Australian Centre for International Agricultural Research (ACIAR) and the State, Society and Governance in Melanesia Project. The aid program has also supported relevant international research on humanitarian and conflict assistance such as Overseas Development Institute (ODI) research on humanitarian and conflict assistance. It is important to maintain these research partnerships.

78. Alongside the more traditional sources of development research, such as the Australian National University (ANU), privately funded think tanks, such as the Australian Strategic Policy Institute and the Lowy Institute, are providing new policy focused analysis and research relevant to the aid program. There is clearly a synergy between the Australian Government's aid program focus on the Asia-Pacific region and the Lowy Institute interest which should be developed to help inform future directions.

79. In view of emerging policy priorities, for example transboundary issues, governance and water, as well as the continuing drive for aid effectiveness, it is important to extend the range of research partners,

particularly within Australia. The emphasis of these partnerships should not only be on producing high-quality research products, but also on founding long-term institutional relationships and developing pools of expertise that can be accessed as needed in an efficient and flexible manner. Consideration should be given to identifying and supporting designated research fellows or organisations to conduct research specifically relevant to the overseas aid program.

DEVELOPMENT STUDIES

80. In addition to the established research links with the aid program, 13 Australian universities offer Development Studies at a range of levels.¹ Other universities offer courses that, while not badged as Development Studies, are relevant, including medicine, engineering, environment and marine studies, particularly in universities that have a research focus in these areas. There is no comprehensive definition and catalogue of courses that might be considered Development Studies and it is difficult to assess accurately the number of students in such courses. However, an informal survey of eight institutions suggests there are approximately 3 500 students currently enrolled in Development Studies.

81. At the same time there is a perception that numbers of students undertaking Development Studies have declined over recent years. During the consultations reference was also made to the diminishing capacity of many Australian universities to train adequate numbers of language and country specialists; and diminished interest/numbers in South-East Asian Studies.

82. The university sector plays an important role in preparing development practitioners and advocates. However, there is seemingly little engagement between the aid program and university teaching programs. Consideration should be given to extending the suitability and availability of development education materials to the tertiary education market.

SCHOLARSHIP PROGRAM

83. Beyond the research engagement and development studies, a selected number of Australian universities each year host some 2 500 scholarship students from developing countries. The role of scholarships as a form of aid is not specifically within the scope of this paper. However the scholarship program was a recurring theme in consultations, especially with the university sector.

84. There is a very broad base of support for the Scholarship program and it is seen as one of the most significant tools of the aid program for direct people-to-people engagement. It is generally recognised that scholarships for study in Australia can play a useful human resource development role by providing priority training in fields where developing countries do not have capacity. They build enduring links between people and their communities, and between institutions and the future leaders of the region and Australia.

85. Clearly there are opportunities for improving and refining the Scholarship Program. However, from an Australian community perspective scholarships are seen as one of the main opportunities to engage with the aid program. Scholarship students interact with the Australian community through the formal academic community, work placements with Australian business, state, territory or local governments, or community groups, and social engagement.

86. The Scholarship Program and the links it creates are highly valued and consideration should be given to both widening and deepening it to introduce new learning modalities including work experience and exchanges in a broader range of disciplines, and ongoing mentoring programs.

DEVELOPMENT EDUCATION

87. AusAID's Global Education Program supports the professional development of primary and secondary teachers across Australia and funds the

¹ The following institutions offer Development Studies: Australian National University, Melbourne University, University of New England, Armidale, Deakin University, Flinders University, La Trobe University, Edith Cowan University, Macquarie University, Monash University, Murdoch University, Northern Territory University, RMIT, and Southern Cross University. In addition, other universities, such as Victoria University, Sydney University and Curtin University offer courses that, while not badged as Development Studies, produce graduates with relevant, often cross-disciplinary skills.

development and production of curriculum material for use in Australian schools. The website (<http://globaleducation.edna.edu.au/>) provides curriculum material on important aid related issues such as globalisation, human rights, developing economies, HIV/AIDS, natural disasters, landmines, refugees, and the environment. Most recently, a new resource 'The Tsunami Disaster—Australia Responds', a joint AusAID and *The Canberra Times* colour education supplement, was added to the website.

88. Teachers in primary and secondary schools are the main users of the Global Education Website, with students accessing activities and resources predominantly under the guidance and direction of their teachers. Secondary audiences include global education professional development providers, students in pre-service teacher training in Australian universities, and teachers and students located in countries in which materials are published on the site. Global Education can build a constituency of support for the aid program based on improved awareness and understanding 'of international issues, development and poverty among Australian school students'.

89. The Caritas Australia submission on the White Paper specifically suggested extending the concept of 'Pacific our Neighbour' by fostering partnerships between schools and education departments in Australia and the Pacific. Caritas Australia believes there to be 'vast opportunities in a program that supports teachers from the Pacific coming to Australia, possibly through school linkages, to...observe and learn different teaching methodologies and approaches. A matching program could support Australian teachers to have an exposure to the issues facing the Pacific'. There could be some synergies between this idea and the Australian Volunteer Program.

90. Development Education is a fundamental building block for development awareness and constituency building, and could provide a focus for greater collaboration between AusAID, development NGOs and government and non-government education agencies.

ENGAGEMENT WITH PARLIAMENTARIANS

91. Members of Parliament (MPs) serve in a number of capacities relevant to the aid program. They represent the interests of their constituents and can be a supporter or critic of aid, as well as serving to inform the broader public on the role and achievements of Australia's aid program. A comprehensive kit on the aid program is provided to all MPs by AusAID, and is updated regularly to keep them informed of key developments.

92. From time-to-time MPs are involved in activities relevant to the aid program such as Certificate of Appreciation ceremonies hosted by Parliamentarians for returned volunteers in their electorates. On occasion MPs also visit aid program activities in country. Some NGOs also have had long and active associations with MPs which serve to inform and garner support from MPs on particular aid issues.

93. At another level, some MPs also serve on key oversight committees on the aid program. These include the Senate Legislative Committee (which oversees budget appropriations), and the Joint Standing Committee on Foreign Affairs Defence and Trade and its Human Rights Sub-committee which conduct public inquiries of direct relevance to the aid program. Such inquiries and their committees can significantly influence the aid program.

94. Discussions with MPs during the White Paper process confirmed the opportunity to build more substantive links between them and the aid program. This could include using MPs as a key source of advice to their counterparts in the region. It may also be appropriate to encourage backbenchers, individually or as groups, to develop long-term relationships, particularly within the region, with a view to creating a knowledgeable group with longer term links to the region. Longer term relationship building would address criticism by partner governments of 'in- and-out' visit patterns.

95. Relationship building with MPs should continue and be used to identify activities which both build a constituency of interest and contribute to the aid program. The opportunity exists to extend and deepen the interest of MPs in Asia and the Pacific, and in the aid program in particular.

ENGAGEMENT WITH THE AUSTRALIAN PUBLIC

96. There appears to be a high—and growing—level of public support for the Australian Government approach to aid in the region. In recent years there has been a significant increase in the number of Australians personally contributing to overseas aid, a large increase in the strength of approval for overseas aid, greater belief in effectiveness, a small shift towards more Australians believing Australia should spend more on aid, greater awareness of NGOs, and an increased community preference for long-term as opposed to emergency aid. Humanitarian or moral reasons continue to be the key motivation for aid. (Newspoll Survey, 2005)

97. Nine out of ten Australians regard reducing poverty as either ‘extremely’ or ‘very’ important issues facing the world today, along with improving health, ensuring world peace, improving education, safeguarding the environment, and combating HIV/AIDS. Around 70 to 80 per cent of Australians rate promoting human rights, strengthening regional security and relationships with neighbouring countries as ‘extremely’ or ‘very’ important. Significantly fewer (around 40 to 45 per cent) see opening world trade and slowing population growth as very important. Community belief in the effectiveness of both Australian Government and non government aid has increased from 53 per cent in 2001 to 71 per cent in 2005. (Newspoll Survey, p. 6,7).

98. Through the AusAID Public Affairs Strategy 2005–2007 the Australian Government seeks to ‘ensure high quality, effective and participatory communication with the public and stakeholders’. This strategy takes into account Australian public opinion research and includes media engagement, the AusAID website, publication of Focus magazine, publication of other key reports, and a development education program targeted at schools. Attachment B outlines the main programs with some statistics giving a brief overview of impact.

99. It is important that the Australian Government builds on this high-level of public interest and support and clearly demonstrates to the public how the current aid program—with its broad ranging emphasis on the MDGs as well as ‘security for

development, innovative approaches to engaging with fragile states, and efforts to combat HIV/AIDS’—contributes to poverty reduction and sustainable development. These are appropriate foundations for the aid program which should be communicated to the Australian public.

100. As the Simons Committee commented, ‘...it is not only legitimate for public funds to be used to inform the public about the aid program, but AusAID has a responsibility to do so’ (*One Clear Objective*, p. 295). Similarly, the Development Assistance Committee of the Organisation for Economic Cooperation and Development (DAC) observed that ‘Greater attention to the impact of development actions on the overall objective to reduce poverty and achieve sustainable development will bring clear benefits in terms of engaging the Australian public/political constituencies’.

101. AusAID’s media and public affairs strategy has been effective but fairly traditional in its approach. A multi-dimensional and targeted community engagement program would extend the fairly passive structure of the strategy. This will have resource implications. Person-to-person communication is expensive, but essential, if the intent is to build Australian community interest in, and support for, long-term development in the region. The value of this approach is demonstrated by the Aid Advisory Council, established in 1998 to provide a forum for broad based discussion by community and industry leaders on aspects of the aid program (See 11th Statement to Parliament, 2002).

102. An opportunity also exists to build on the success of the Town Hall meetings conducted by the Parliamentary Secretary for Foreign Affairs (see Attachment A). The Town Hall meetings were well attended and well received. It is also consistent with calls at the Town Hall meetings to ‘encourage public interest and expertise...including through the media and campaigns like Make Poverty History’ (White Paper Forums, Summary of Public Input, www.ausaid.gov.au).

103. Extended community engagement needs to be supported by a re-focused and proactive public affairs strategy with sufficient flexibility and resources to support the evolving aid framework, engage

with new players and maintain existing public engagement. The AusAID public affairs capacity should be aligned more strategically to both program changes emerging from the White Paper as well as the proposed Community Engagement Program. It should be research-based and aim to impact on stakeholders who influence the aid debate and, in turn, the public.

104. It is proposed that the Australian Government put in place a three-year program of Town Hall meetings to inform the Australian public about developments in the aid program and invite feedback and ideas. The purpose of these meetings should be clearly identified and the success reviewed annually.

MEDIA

105. The Australian media is identified as having an important role to play in maintaining a more engaged community. The *Guide to the Core Group* for the White Paper defined media as ‘groups and journalists that serve to critique and educate the public on development issues and influence government’.

106. Engaging with the media through the consultation process highlighted what seems to be a relatively low level of interest in the aid program except for stories which will hold reader interest in a competitive market. This contrasts with evidence that in Europe, the United Kingdom and the United States, media is more actively involved in generating and extending debate on development issues.

107. Generally, humanitarian assistance stories dominate Australian media coverage of overseas aid. This was particularly evident in the wake of the Tsunami. The Australian response to this massive destruction was mobilised very quickly to meet the immediate needs of the people in affected areas. People could see through the media a real and immediate outcome from aid to Tsunami victims. As time passes, it is critically important that the Australian public receives regular and comprehensive feedback on progress with the much longer term reconstruction efforts and, in particular, what has happened to the money.

108. Despite the high level of public interest in knowing how and where the Australian contribution is being spent, the media response to the two joint press conferences held to date has been minimal. This points to the importance of a multi-faceted approach to ensure the Australian public is informed about the aid program. Development, as it is often said, is risky and long term. Without an effective and long-term communications strategy aimed at keeping the public engaged, both the Australian Government and NGOs are vulnerable to significant loss of public support for overseas aid should reporting focus on less than successful interventions.

109. At a broader level, the media is an important element of civil society. Linkages between media groups and journalists in Australia and those in our region could assist significantly with capacity building and strengthening civil society and governance. ‘A strong and free media, together with an effective parliament and an independent judiciary, is an essential part of a democracy. When people lack access to information relevant to their lives, or a participatory voice within a democracy, they are denied an important means for determining their future...In contrast, a strong media can help to create the ‘demand’ for good governance.’ (Extract from the ‘Media for Development Initiative Project Design Document’, 2004).

110. To generate greater media coverage of the longer term and substantive policy issues surrounding the aid program, there needs to be a targeted media communications strategy aimed at engaging significant and credible media players in dialogue about development. Options for additional linkages between Australian media and media practitioners in our region should be further examined as a part of efforts by the aid program to strengthen demand-led governance.

KNOWLEDGE MANAGEMENT

111. The AusAID Strategic Plan 2001 defines knowledge management as ‘the process through which an organisation’s lessons from past experience are combined with the information and understanding of its employees to improve organisational performance and adaptability

to change.’ This provides a necessary and understandable internal focus for knowledge management. It is equally important to capture and share the knowledge that exists in the broader community.

112. AusAID’s knowledge management system includes the:

- > Information and Research Services Unit
- > AusAID Knowledge Warehouse (AKWa)—see below
- > AusGuide—a guide for AusAID staff, contractors and others engaged in delivery of aid
- > Country Program Infoshare – a tool for collaboration and knowledge sharing across AusAID, especially between Canberra and posts
- > AidWorks, an integrated platform for AusAID knowledge systems
- > Australian Development Gateway—see below.

(From DAC Review Presentation by Assistant Director General, Office of Review and Evaluation, 6 July 2004)

113. AKWa is a database aimed at improving the quality of the Australian overseas aid program. There are two versions—an internal version that contains more than 600 documents and an external version (a subset of the internal version) containing more than 200 documents. AKWa aims to improve the quality of Australian aid. It contains only documents considered to be of direct relevance to project and program quality. AKWa typically receives about 200 internal visits and 3 500 external visitors per month.

114. The Australian Development Gateway is part of the World Bank Development Gateway network of more than 50 country gateways. It aims to ‘support members of the development community in their efforts to reduce poverty and enhance sustainable development in the Asia Pacific region’ by providing development professionals with the opportunity to share information (www.developmentgateway.com.au). The site focuses on seven sectors—agriculture, disaster management, education, governance, health, information and communication technologies, and water. Partners provide quality assurance services and content for the site.

115. In the past few years there has been a growth of interest in knowledge management within the Australian Public Service. The definition and

understanding of knowledge management has improved and expanded over time: ‘Knowledge management is a multi-disciplined approach to achieving organisational objectives by making the best use of knowledge. It involves the design, review and implementation of both social and technological processes to improve the application of knowledge, in the collective interest of stakeholders’ (Standards Australia 2003, p. 3).

116. The 2001 AusAID Information Management Study concluded that the culture within the organisation is predominantly oral. Much of the detail on ‘how things are really done’ lies in the heads of AusAID staff, leaving the agency vulnerable to loss of corporate knowledge as people leave. An oral culture is not necessarily a learning culture and can hamper productive knowledge transfer. An oral culture also lacks the rigour and objectiveness of evidence-based data, and information and knowledge essential to critical thinking and analytical capacity.

117. The consultation process revealed a sense of frustration amongst development practitioners in relation to information sharing. This is evidenced by the strong call for AusAID to facilitate improved inter-sectoral and inter-agency knowledge gathering and sharing as a means of overcoming the perceived absence of opportunities to publicly identify or acknowledge innovative and effective contributions to sustainable development. Development practitioners want to share ideas and approaches to implementation and benefit from ‘knowledge sharing of our key learning’.

118. While people seemed generally aware of the availability of the tools on the AusAID website there was a desire for AusAID to move from information giving to a more interactive mode of knowledge sharing and knowledge creation. The aid program can only benefit from improvements in AusAID’s knowledge management systems and a robust approach to knowledge sharing which encourages contestability of ideas.

119. AusAID’s approach to knowledge management has been to strengthen formal and informal systems. To encourage information sharing and provide the appropriate environment for knowledge creation there needs to be investment in building and promoting the existing knowledge management

infrastructure. While improved information and communication technology will provide the means of facilitating a sharing environment, new and upgraded technology will not itself guarantee a learning culture or that knowledge will be shared.

120. A significant challenge will be to encourage a culture in AusAID that values sharing of information. Based on the experience of other government agencies, there will need to be changes in cultural and business processes to encourage trust and openness, collaboration, shared purpose, and value sharing (refer www.oit.nsw.gov.au).

121. It is timely for AusAID to review existing systems and business processes to develop and implement a Knowledge Management Strategy which improves access to information, experience and expertise within the agency, improves business processes and enhances policy and analytical capacity. Improved knowledge management within AusAID, together with improved knowledge sharing with the development community (as a part of improved community engagement) will contribute to improved aid effectiveness.

NETWORKS AND FORUMS

122. Knowledge sharing also needs forums in which people can discuss theories, issues, contexts, methodologies, and case studies. Existing opportunities include:

- > the Development Studies Network, which provides broad based opportunities for exchange of knowledge of global issues and development related research
- > the Centre for Democratic Institutions which aims to harness Australian and international best practice in support of developing countries' needs for democratic governance
- > national and international conferences which bring together specialists (for example, on HIV or agriculture).

123. During the consultation process development practitioners, researchers, experts, and others strongly favoured engaging in dialogue and sharing knowledge and experience—the lessons learned—through thematically focused forums and networks.

The DAC Report also proposed that 'AusAID should reinforce its investment in development education in order to foster a broader and better informed public debate on international development issues, including where appropriate supporting civil society organisations' (2004 DAC Report, Executive Summary).

124. There is a high level of enthusiasm in the development community for sharing knowledge and experience in forums that cross the boundaries of existing silos, to enable development practitioners and others to make contact and build communities of practice where interested participants can regularly engage in sharing and learning.

125. As well as improving policy dialogue, creating communities of practice could also provide opportunities to improve designs and methods of peer review. Return on investment could also be improved, especially if such communities of practice can engage the practitioners employed by development contractors, who seem especially shut out by current dialogue that focuses on contractual matters and is limited by perceptions of commercial confidentiality.

126. AusAID could add value to the current range of opportunities by facilitating the coming together of selected specialists to address development themes or issues. Convening such forums and networks could be outsourced to universities, think tanks, ACFID, or other organisations with the capacity to identify and maintain a level of interest.

FUTURE DIRECTIONS

127. The Australian Government will continue to rely on the Australian development community to inform and support the medium-term, strategic outlook for the aid program. Further strengthening of the relationship between the aid program and the Australian community should be purposeful and strategic in support of enhanced Australian Government capacity to deliver development outcomes and increase public understanding of the Australian aid program.

128. The need for engagement of new partners in the aid program will be determined by the final outcomes of the White Paper. New directions for the program may identify gaps in the level of expertise and experience of those delivering service and point to the need for new partners.

129. The aid program must maintain and extend delivery arrangements as well as identify new partners. In seeking to enhance its capacity to deliver strategic development outcomes, the aid program must move beyond dealing with its Australian partners—current and potential—solely as implementers and develop new approaches that build on, and leverage off, the extensive development knowledge and capability within the Australian development community.

130. New players are best identified through a long-term and strategic approach to community engagement which specifically seeks to identify

potential new partners and build on the capacity and willingness of existing partners to participate in ‘innovative approaches to alliances and partnerships across the development sector’ (ACFID Submission, p. 4).

131. An important feature of engaging with new partners will be to identify program priorities and then target key partnerships that can deliver key outcomes. These could include whole-of-government and country/regional priorities, tapping into the ideas market through strengthened development forums and networks, and appropriate cost benefit analysis of new engagement strategies. Above all, AusAID must be strategic with its partnerships and activities. It cannot be all things to all people.

132. A new approach to community engagement which seeks both to ensure that the community is informed about and supportive of the emerging aid program as well as extending partnership will present significant challenges.

133. Effective community engagement needs to be strategic, long term, valued, and supported. It will require deliberate, considered and mutually determined collaborations with the purpose and limits of engagement clearly identified and agreed. Being clear and upfront about the purpose and extent of engagement gives interested groups the opportunity to determine their willingness to participate. It will also require substantial commitment of resources, both time and money.

Community engagement is time consuming and may not produce significant results immediately.

134. A more active approach to community engagement also means valuing Australian practitioner knowledge and being ready to welcome contestability of ideas and engage with critical thinking. A challenge for AusAID will be to look beyond the immediate, pragmatic and action oriented approach which characterises the current mode of engagement to longer term, more interactive engagement with partners that stimulates the contestability of ideas.

135. There needs to be concerted effort to capture knowledge and experience and share the learning of development practitioners. This requires not only investment in infrastructure to support knowledge management but also an openness and sustained commitment to seeking new ideas. Without this investment, much of the effort which goes towards community engagement, will, over time, become a disinvestment. AusAID should also create high level forums/roundtables and cross-sectoral dialogue opportunities to encourage knowledge sharing and contestability of ideas.

136. There is currently an inherent weakness in the management of community engagement in the Australian overseas aid program—it is neither systematic nor strategic. A strategically focussed program is needed to build on the current broad ranging approach to community engagement and to support new and emerging directions in the aid program.

RECOMMENDATION: A THREE-YEAR COMMUNITY ENGAGEMENT PROGRAM

137. It is recommended that the Australian Government establish a three year Community Engagement Program, specifically focussed on maximising the expertise and experience offered by its various partners; identifying new partners with skills relevant to new and emerging development issues, and sustaining high public support for the aid program.

138. The goals of a refocused and more strategic approach to community engagement should be to:

- > build on the capacity and willingness of existing partners to participate in innovative approaches to enhance development outcomes.
- > identify priorities for new partnerships and relationship building
- > introduce more flexible approaches to engagement that encourage new and different partnerships
- > strengthen and deepen the constituency of interest and support for the existing aid program
- > capture the knowledge and experience of lessons learned, particularly from development practitioners, to contribute to knowledge creation and sharing
- > encourage contestability of ideas through further investment in research and forums engaging a broad spectrum of interest and experience—including other government agencies, the corporate sector, think tanks, universities, and practitioners

139. A refocused and strengthened commitment to community engagement needs to be underpinned by upgraded support for knowledge management and a pro-active public affairs strategy.

140. Strategies to assist in achieving the goals of the proposed three-year community engagement program have been identified throughout this paper and are summarised in Attachment 1.

141. This program should be evaluated and reviewed after three years.

NOTE OF THANKS

142. The authors would like to thank all those who gave generously of their time and views to inform this paper. We commend the Secretariat and the Public Affairs Group for their support and for coordinating the Town Hall meetings.

Appendix 1: Strategies for Community Engagement

ENGAGING WITH DEVELOPMENT CONTRACTORS

Breaking down the silos in which AusAID engages with its partners and bringing practitioners, experts, researchers, and others together in high-level thematically focused forums would encourage sharing of knowledge and experience, contestability of ideas and input to policy development. It is also suggested that incentives for documenting learning in the field would encourage contribution to development related research by development contractors.

Commercial contracts should be further untied, to encourage internationally competitive tendering.

ENGAGING WITH NGOS

As the aid program responds to changes both within the broader development context and the region, it is timely for AusAID and ACFID to reconsider their relationship with a view to engaging in more productive and mutually effective ways that enhance policy dialogue and contribute to aid effectiveness. It is proposed that AusAID and ACFID cooperate in long-term empirical research aimed at confirming the Australian NGOs' claims of effectiveness with a view to scaling up where appropriate.

The Government should reaffirm the importance of ANCP and Accreditation as the primary tools for engaging with Australian professional development NGOs.

VOLUNTEERS

Support for volunteering should continue, as volunteering is a valuable form of community engagement. Moves to increase the volunteer program should be considered in light of the White Paper and recent increases, such as doubling of the Australian Youth Ambassadors for Development Program and increased funding to the Australian Volunteer Program.

ENGAGING WITH CBOS

If service delivery partnership opportunities are extended to CBOs, then new and different rules of engagement will be needed. Such arrangements, while more flexible, must also have sufficient provision for accountability to provide a level of confidence in an organisation's capacity to contribute to the specified and agreed development outcomes. Such mechanisms should not be introduced simply as opportunities to fund good intentions and good ideas. Shared accountability and commitment to long-term development effectiveness is a prized asset. It contributes to the high levels of community support for the aid program and should not be compromised.

Rather than seeking to include the full range of these CBOs in the aid program, it may be more efficient to put them in contact with other organisations active in service delivery through a brokering facility. This could be similar in concept to the Industry Capability Network, which facilitates business partnerships for the purpose of local supply, access to global supply chains and local business growth. Another alternative would be to better promote the Direct Aid Program and Small Activities Schemes that operate at Diplomatic Missions, with a view to enabling the local counterpart of an Australian group to apply for assistance. Given the number of approaches to AusAID, consideration needs to be given to establishing a cost effective process to evaluate ideas and offers of goods or services. To avoid raising expectations there will need to be absolute clarity about how far the door is open.

ENGAGING WITH THE CORPORATE SECTOR

As a matter of priority, AusAID should identify and engage with companies that have investment interests in the region with a view to creating partnerships and alliances that strengthen development outcomes. Other opportunities for

engaging with the corporate sector include working through the PMCBP to encourage CR reporting by Australian based companies with operations in Asia and the Pacific; giving profile to improved engagement with the corporate sector by creating an overseas development award linked to the PMCBP; and supporting NGO efforts to work effectively with the corporate sector towards a shared understanding of sustainable development.

ENGAGING WITH THE PUBLIC SECTOR

The aid program should also expand its efforts to engage with state, territory, and local governments to identify appropriate partners. The aid program could benefit from coordinated and ongoing linkages to state organisations such as the Queensland International Aid and Development Business Unit, as well as other state departments and agencies. Current engagement with the Australian Local Government Association (ALGA) should be continued and strengthened. Consideration should also be given to expanding the PSLP to other public sector organisations such as public hospitals.

ENGAGING WITH UNIVERSITIES AND RESEARCH INSTITUTIONS

In view of emerging policy priorities, for example transboundary issues, governance and water, as well as the continuing drive for aid effectiveness, it is also important to extend the range of research partners, particularly within Australia. The emphasis of these partnerships should not only be on producing high-quality research products, but also on founding long-term institutional relationships and developing pools of expertise that can be accessed as needed in an efficient and flexible manner. Consideration should be given to identifying and supporting designated research fellows or organisations to conduct research specifically relevant to the overseas aid program.

DEVELOPMENT STUDIES

The university sector plays an important role in preparing development practitioners and advocates. However, there is seemingly little engagement

between the aid program and university teaching programs. Consideration should be given to extending the suitability and availability of development education materials to the tertiary education market.

SCHOLARSHIPS

The Scholarship Program and the links it creates are highly valued and consideration should be given to both widening and deepening it to introduce new learning modalities including work experience and exchanges in a broader range of disciplines, and ongoing mentoring programs.

DEVELOPMENT EDUCATION

Development Education is a fundamental building block for development awareness and constituency building, and could provide a focus for greater collaboration between AusAID, development NGOs and government and non-government education agencies.

ENGAGING WITH PARLIAMENTARIANS

Relationship building with MPs should continue and be used to identify activities which both build a constituency of interest and contribute to the aid program. The opportunity exists to extend and deepen the interest of MPs in Asia and the Pacific, and in the aid program in particular.

ENGAGING WITH THE AUSTRALIAN PUBLIC

Extended community engagement needs to be supported by a re-focused and proactive public affairs strategy with sufficient flexibility and resources to support the evolving aid framework, engage with new players and maintain existing public engagement. The AusAID public affairs capacity should be aligned more strategically to both program changes emerging from the White Paper as well as the proposed Community Engagement Program. It should be research-based and aim to impact on stakeholders who influence the aid debate and, in turn, the public.

It is proposed that the Australian Government put in place a three-year program of Town Hall meetings to inform the Australian public about developments in the aid program and invite feedback and ideas. The purpose of these meetings should be clearly identified and the success reviewed annually.

MEDIA

To generate greater media coverage of the longer term and substantive policy issues surrounding the aid program, there needs to be a targeted media communications strategy aimed at engaging significant and credible media players in dialogue about development. Options for additional linkages between Australian media and media practitioners in our region should be further examined as part of efforts by the aid program to strengthen demand-led governance.

KNOWLEDGE MANAGEMENT

It is timely for AusAID to review existing systems and business processes to develop and implement a Knowledge Management Strategy which improves access to information, experience and expertise within the agency, improves business processes and enhances policy and analytical capacity. Improved knowledge management within AusAID, together with improved knowledge sharing with the development community (as a part of improved community engagement) will contribute to improved aid effectiveness.

NETWORKS AND FORUMS

AusAID could add value to the current range of opportunities by facilitating the coming together of selected specialists to address development themes or issues. Convening such forums and networks could be outsourced to universities, think tanks, ACFID, or other organisations with the capacity to identify and maintain a level of interest.

Attachment A: Town Hall flyer



Australian Government
AusAID

PUBLIC CONSULTATION **White Paper on Australia's** **Overseas Aid Program**

The Australian Government is developing a White Paper, to be tabled in Parliament in early 2006, which will be a strategic blueprint for the future direction of Australia's overseas aid program.

As part of this process, the Government, through AusAID, is consulting a broad range of specialist groups. The Government seeks the views of interested members of the Australian community on the future directions of the aid program.

The Parliamentary Secretary for Foreign Affairs, the Hon Bruce Billson MP, invites members of the public interested in aid and development issues to have their say at a special public meeting in Sydney on 21 September 2005.

Through the overseas aid program, Australia helps our neighbours reduce poverty and achieve sustainable development. For example, the aid program was a central component of Australia's response to the December 2004 Indian Ocean disaster.

Our aid program supports poverty alleviation around the world with the main focus on the Asia Pacific region, particularly our immediate neighbours.

Date: 5.30–7.30pm, Wednesday 21 September

Venue: City Recital Hall, Angel Place, Sydney (between Pitt and George Streets, near Martin Place)

RSVP essential — rsvpnsw@horizoncommunication.com.au or Claire Dean on 02 8572 5600

For more information on the White Paper including methodology and discussion papers visit www.ausaid.gov.au

Attachment B: Existing mechanisms for community engagement

Business and industry activity	Description	Participants	Frequency
Development Contractors Forum	To discuss policy and operational issues and brief contractors on latest developments in AusAID.	AusAID management and contractors wishing to do business with AusAID	Six monthly
Access AusAID seminars	Occasional seminars held around Australia to advise private sector how to access AusAID business	Open to all	As requested by business associations or state and territory governments
International Development Contractors Group Meeting (IDC)	To discuss issues of concern to their members and AusAID	Members of the IDC Executive and AusAID management	Six monthly
Contractor policy dialogues	To discuss contemporary policy issues whether they are operational or development based.	AusAID management and selected contractors	As required
Business Councils	Australian/developing country business councils	AusAID officers sometimes attend to provide information on particular issues	As required
Activity type / development NGO activity	Description	Target participants	Statistics/frequency
Committee for Development Cooperation	AusAID/NGO advisory and consultative body—policy input to accreditation and ANCP	Six elected NGO representatives and six AusAID representatives	Three times per year
Top 11 meetings	AusAID/NGO discussions on current events and issues	Selected NGO CEOs, AusAID Director General, other AusAID staff	Twice per year
Multilateral Development Bank (MDB) NGO consultants	Discussion on WB/IMF/ADB policy	Selected NGOs, AusAID and Treasury staff	Twice per year
AusAID/ACFID annual consultation	Discussion of policy and operational issues	ACFID members and selected AusAID staff	Annually
NGO policy dialogues	Discussion of recent developments and significant issues	Relevant Deputy Director General AusAID (DDG) and Accredited NGOs (ACFID also)	Two to three times per year
ACFID Working Groups	Sub group discussion of areas of interest eg. performance, country specific	AusAID and NGO reps with interest in area	As required
Media/public diplomacy	Description	Target	Statistics
Internet	General aid information through to specific activities	All interested in any aspect of program. Starting point for those interested in more detail	1.091 million hits during 2003–04 70 000 publications downloaded each month
Media liaison	Media inquiries and proactive approaches, media visits, press conferences, media briefings, editorial, media releases, MP briefings, documentary development, community service announcements	General media and specialists with a view of accessing interested public	525 media releases 549 media requests 371 speeches during 2003–04
Global Education	Development education material and curriculum, separate Global Education website, teacher training	Educational institutions in all states and territories	15 000 teachers trained 8 000 curriculum docs 558 482 hits to May 2004

Media/public diplomacy	Description	Target	Statistics
Community engagement	Shows, industry days, community events, exhibitions, displays, public meetings, conferences, seminars, sponsorship	General public	5.1 million audience during 2003–04 140 MPs involved
Publications	Extensive range of general and specific publications, including <i>Focus</i> , AusAID's flagship magazine, agency policy and program analysis publications	All interested in aid program	19716 subscriptions to <i>Focus</i> 83 600 publications sent out 2003–04
Other activity	Description	Participants	Statistics
Australian Development Gateway	Internet site sharing development knowledge	Development practitioners (domestic and overseas) focus Voluntary contributions from Australian organisations	Over 24 000 hits per month in July 2005, long-term trend upwards

MECHANISMS BY WHICH AUSAID ACCESSES COMMUNITY EXPERTISE

Mechanism	Eligibility	Value
ANCP	Accredited NGOs in a pooled funding arrangement.	\$25.5 million (Budget 05–06)
NGO Cooperation Agreements	Accredited NGOs; competitive process.	Various commitments— no current summary total available
Contracts/Tender process	Implementation activities: firms must carry on business in ANZ or be local firms in the recipient country. Exception is LDCs which are open to any organisations worldwide. No restrictions apply to procurement for individuals.	1300 new contracts/value approx \$812 million (actual 04–05) Annually AusAID manages about \$3 billion in contracts
Public Sector Linkages Program (PSLP)	Departments, agencies and statutory authorities from the Australian Government, state and territory governments, and public universities.	\$8 million (Budget 05–06 from relevant country programs)
International Seminar Support Scheme (ISSS)	Assists participants from developing countries to attend development-oriented seminars in Australia; sponsor/co-sponsor must be an Australian organisation.	\$1.2 million (Budget 05–06)
AusAID Development Research Program	A flexible, competitive fund to facilitate cross-agency research, as well as strategic partnerships with selected research institutions.	\$2.3 million (Budget 05–06)
Australian Volunteer Program	Individuals are eligible to apply to be volunteers through the Core Program (contracted to AVI, ABV and Austraining) and the Australian Youth Ambassadors for Development Program. In addition, Australian organisations can become Partner Organisations in the volunteer program.	Core Volunteer Program \$16 million (Budget 05–06) AYAD \$10.5 million (Budget 05–06)

Attachment C: Contributors to consultations

The following list is not exhaustive. It does not include all who participated in some group consultation meetings. Our thanks to all who made time to speak to us.

ABC Radio Australia, Sean Dorney, Pacific Correspondent

Abyss Pictures, Brenton Dean

ACIL Australia Pty Ltd, Jill Byrne, Executive Director and Partner

ACIL Australia Pty Ltd, Susan Majid, Senior Consultant

ACUS Tanks, Nigel T Warin, Managing Director

Adelaide Advertiser, Rex Jorey, Columnist

Anglicord, Greg Thompson, CEO

Austcare, Major General Michael Smith, AO, CEO

Austrade, Jodie McAlister, Project Manager, Corporate Policy and Projects

Austraining International, Kym Davis, CEO

Australia Fiji Business Council, Ian Felton, Vice-President (and member of the executive committees of the Australia-Pacific Islands Business Council and the Australia-PNG Business Council)

Australian Chamber of Commerce and Industry, Dr Brent Davis, Director, Trade and International Affairs

Australian Conservation Foundation, Tan Lee

Australian Council for International Development, Paul O'Callaghan, Executive Director

Australian Foundation for the Peoples of Asia and the Pacific Ltd, David Brett, Program Manager

Australian Local Government Association, John Pritchard, Executive Director, Policy and Research

Australian Local Government Association, Katie Whitehead, Director, National Events and International Liaison

Australian National University, Development Studies Network, Dr Pamela Thomas

Australian Red Cross, Katica Dias

Australian Volunteers International, Dimity Fifer, CEO

Australian Volunteers International, Peter Britton

Burnet Institute, Mike Toole, Head, Centre for International Health

Burnet Institute, Clement Malau, Public Health Management Specialist, Centre for International Health

Cardno, David Merrett, Principal, Business Unit Manager

CARE Australia, Robert Glasser, CEO

CARE Australia, Sarah Gowty, Project Officer

Christian Blind Mission International Australia, Paul Deany, Advocacy Officer

Cisco Systems, Martin Stewart-Weeks, Executive Advisor, Internet Business Solutions Group

Connell Wagner, Simon Fraser, Manager, International Development Assistance

Curtin University of Technology, Professor Kevin McKenna, Pro Vice-Chancellor International, International Office

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Deacons, Kevin Hobgood-Brown, Partner

Department for Victorian Communities, Dr David Adams, Executive Director, Strategic Policy and Research

Engineers Without Borders Australia, Daniel Almagor, President

Foundation for Development Cooperation, Beris Gwynne, Executive Director

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GHD P/L, Peter Robson, Manager, Business Development, International Development	Marie Stopes International Australia, Ary Laufer, Regional Manager, Pacific Asia Programs
Gordon Eye Surgery, Dr Geoffrey Painter, Ophthalmic Surgeon	Melbourne University Private, Ian Hind, Executive Dean, School of International Development
Griffith University, Alyson McGrath, Manager, International Student Services	Murdoch University, Asia Research Centre, Professor Garry Rodan, Director
Griffith University, Associate Professor Leong H. Liew, Head of Department, Griffith Business School	Murdoch University, Asia Research Centre, Dr Jane Hutchison, Fellow
Griffith University, Christopher Madden, Pro-Vice Chancellor (International)	National Association of People Living with AIDS, John Rock, International Portfolio Convenor
Griffith University, Ingeborg Loon, Deputy Director, International Marketing	National Council of Churches in Australia, Carlos Ocampo, Manager, International Programs
Griffith University, Professor Michael Wesley, Director, Griffith Asia Institute	Nestle Pacific Islands, Jason A Chan, General Manager
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Institute of Public Affairs Limited, Mike Nahan	Rotary Australia World Community Service, David Moore, CEO
International Development Support Services Pty Ltd, Dr Michael Henry, Managing Director	Rotary Club of Mount Gambier West, Bob Furner, Company Secretary
Interplast Australia, Donald Marshall AM, Clinical Associate Professor of Surgery, Plastic and Reconstructive Surgery	Royal Australasian College of Surgeons, Daliah Moss, Director, Fellowship and External Affairs
Interplast Australia, Prue Waters	SAGRIC International Pty Ltd, Rod Reeve, Chief Operating Officer
JTA International, Jane Thomason, Director	SAI Global, Bruce Balmond, Lead Auditor
JTA International, Chris Wheeler, Senior Project Manager	Save the Children Australia, Cathy Emery, Program Manager – Pacific
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Glossary

ABV	Australian Business Volunteers
ACIAR	Australian Centre for International Agricultural Research
ACFID	Australian Council for International Development (formerly ACFOA)
ACFOA	Australian Council for Overseas Aid
ADB	Asian Development Bank
AIDS	Acquired Immune Deficiency Syndrome
AKWa	AusAID Knowledge Warehouse
ALGA	Australian Local Government Association
ANCP	AusAID-NGO Cooperation Program
ANU	Australian National University
AVI	Australian Volunteers International
AYAD	Australian Youth Ambassadors for Development
CDC	Committee for Development Cooperation
CPP	PNG Churches Partnership Program
CR	Corporate Responsibility
DAC	Development Assistance Committee of the Organisation for Economic Cooperation and Development
DDG	Deputy Director General of AusAID
GRI	Global Reporting Initiative
HIV	Human Immunodeficiency Virus
IMC	International Mining Council
IMF	International Monetary Fund
ISSS	International Seminar Support Scheme
MDG	Millennium Development Goals
MDB	Multilateral Development Bank
MP	Member of Parliament
NGOs	non-government organisations
ODI	Overseas Development Institute
PMCBP	Prime Minister's Community Business Partnerships
PNG	Papua New Guinea
PSLP	Public Sector Linkages Program
VIDA	Volunteers for International Development from Australia



Australian Government
AusAID

11

HIV/AIDS in the Asia Pacific Region

Analytical report for the White Paper on
Australia's aid program

Prepared by
Annmaree O'Keeffe, John Godwin
and Dr Rob Moodie

OCTOBER 2005

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Disclaimer: The views expressed in this report are those of the authors and do not necessarily represent the views of the Australian Government.

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Preface

This Report has been commissioned by AusAID to inform the development of the White Paper on Australia's Aid Program, which is to be tabled in Parliament in early 2006.

The Report describes the key issues likely to shape Australia's response to the HIV/AIDS epidemic in the Asia Pacific region over the next decade (2005–2010). The purpose of the Report is to define the key HIV/AIDS issues to be considered by the Australian Government in developing the White Paper, and to stimulate public discussion and debate regarding these issues. The Report includes recommendations regarding areas for possible future investment by the Australian Government and suggestions on new ways of working to respond more effectively to future needs. These recommendations were considered at a Community Consultation meeting on the HIV/AIDS aspects of the White Paper convened in Sydney in September 2005.

A major focus of the Report is the Australian Government's role in responding to the global epidemic; however consideration is also given to the important roles played by non-government actors in the response. Where the Report refers to Australia's role, it is intended to refer to the entirety of Australia's multi-sectoral response to the epidemic—comprising the efforts of the Australian Government, the state and territory governments, the medical and research sectors, NGOs, and community groups.

The views contained in the Report are those of the authors and do not represent the position of the Australian Government.

The Report was informed by input from an Expert Reference Group convened by AusAID, the membership of which is as follows:

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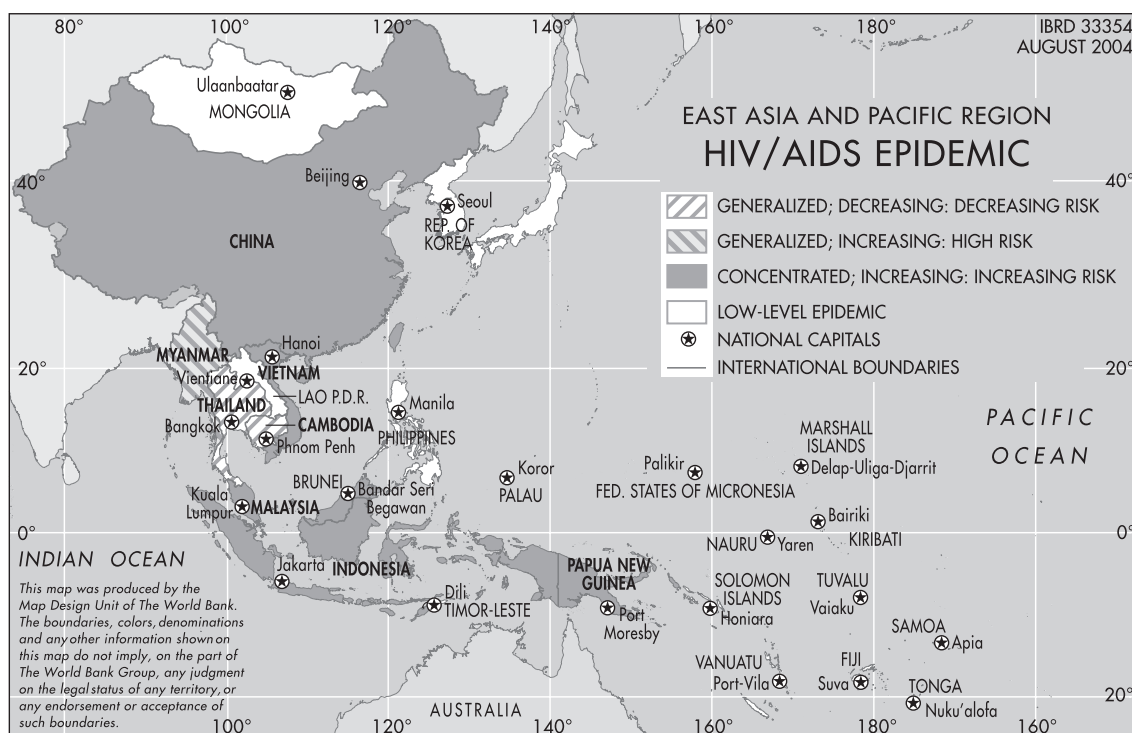
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Source: Addressing HIV/AIDS in East Asia and the Pacific, World Bank, 2004.

nb PNG should now be classified as: Generalised, increasing; high risk.

Executive summary

HIV/AIDS is not simply a health threat; it is a development challenge. This global epidemic threatens to undermine development achievements as it increasingly impacts on a broad range of social and economic issues particularly in developing countries where health, education and other basic government systems are inadequate to fight the battle. Combating this development challenge requires comprehensive action which recognises that HIV/AIDS often emerges from the same societal and economic conditions that confound poverty alleviation.

The Asia Pacific region is experiencing escalating HIV/AIDS epidemics that are diverse and require multiple responses. These epidemics have unique features and are different from those in Africa. Countries in East and South-East Asia are experiencing epidemics driven largely by injecting drug use and sex work. In the Pacific, the situation varies, with the arc of Melanesian countries sharing socio-cultural factors that contribute to HIV vulnerability—such as high levels of sexual partnering, gender inequalities, high rates of sexual assault, and low literacy levels. Papua New Guinea (PNG) has an escalating generalised HIV/AIDS epidemic. Other Pacific Island countries are experiencing as yet low level, nascent epidemics driven by sexual transmission. Each of these epidemics has specific social, cultural and economic determinants and impacts. Throughout Asia Pacific, the stigma associated with HIV/AIDS is a

major constraint, impeding work with vulnerable populations and reducing the availability and quality of health care.

It is highly unlikely that an effective preventive vaccine for HIV or cure for AIDS will become available in the next decade. It is probable, however, that in the medium term new biomedical approaches to prevention such as microbicides, advances in the use of antiretroviral drugs (ARVs) for prevention and treatment, and development of new monitoring and diagnostics tools designed for resource poor settings, will provide new tools for fighting the epidemic. Even with existing approaches, successes in prevention and in providing treatment and care on a large scale are possible in the region. A central guiding principle for successful responses is an evidence-based approach.

There has been a tendency to define HIV/AIDS as a disease of poverty. Poverty contributes greatly to HIV/AIDS vulnerability and the epidemic impacts heavily on populations that are socially and economically marginalised. However in Asia Pacific there is also a close association between HIV/AIDS, market growth and economic activity.

A greater focus on the gender aspects of the epidemic is required including improved understanding of how male and female social roles affect vulnerability. Feminisation has emerged as a major feature of the epidemic in sub-Saharan Africa where the majority of new infections are in women. A similar pattern is

likely to emerge in PNG and other countries in the region that experience generalised HIV epidemics.

As the Asian and Pacific HIV/AIDS epidemics expand and affect a higher percentage of the general population, new family and community impacts will emerge. Orphan care and support issues, paediatric treatment and care, and mother-to-child transmission issues are likely to assume greater importance in highly affected Asian countries and PNG. Critical sectors of the workforce such as teaching, health care and policing may experience labour shortages.

Australia has positioned itself to play an ongoing and leading role in generating political commitment to HIV/AIDS in Asia Pacific. This has been a joint effort of government and civil society, with Australian NGOs and community groups playing an increasingly important role in contributing to HIV responses in the region.

Priorities for action for the next decade will need to focus on:

- > Building leadership momentum, recognising that HIV/AIDS is a political challenge. Parliamentarians, community leaders and the business sector will need to be harnessed more effectively as part of this leadership work with an emphasis on HIV/AIDS as a core development issue. Governance initiatives will need to be explored to underpin sustainable responses.
- > Implementing comprehensive and sustained prevention approaches. This will require expanded community mobilisation, the adoption of comprehensive harm minimisation frameworks, the strengthening of enabling law and policy environments, and the development of an evidence base. The role of antiretroviral therapy (ART) as part of the prevention approach needs to be expanded, whilst also scaling up community based prevention programs for vulnerable groups. Blood safety and infection control remains a continuing need in prevention.
- > Expanding Australia's contribution to the delivery of ART effectively in resource poor settings. This will involve strengthening workforce capacity, improving testing and monitoring and supporting

access to affordable treatments through trade policy.

- > Addressing gender aspects including male roles and feminisation of HIV epidemics.
- > Expanding and continuously improving the evidence base.
- > Strengthening whole-of-government coherence in the aid program's response to HIV/AIDS in Asia Pacific.
- > Looking for new ways of working, including rapid response capabilities, harmonisation and collaborative approaches, policy engagement, regional capacity strengthening, and collaborative technical assistance approaches with development partners.

1 The challenge

1.1 THE NEXUS BETWEEN HIV/AIDS AND DEVELOPMENT

HIV/AIDS is a development challenge. Meeting this challenge demands a long-term vision. It is an evolving and exponentially destructive disease that strikes at the centre of a society's most productive and essential groups—its workers and its parents.

As the global numbers of those infected and affected continue to rise, it is clear that HIV/AIDS predominantly impacts on the world's most vulnerable—the most vulnerable individuals, most vulnerable groups and most vulnerable countries. Nine out of every ten people living with HIV/AIDS live in the developing world. Combating this development challenge requires comprehensive action that recognises that HIV/AIDS very often emerges from the same societal and economic conditions that confound poverty alleviation.

1.2 ESCALATING EPIDEMICS IN ASIA PACIFIC

The Asia Pacific region is experiencing escalating HIV/AIDS epidemics that are diverse in nature and require multiple responses. These epidemics have unique features and are different from those in Africa.

Countries in East and South-East Asia are experiencing epidemics driven largely by injecting drug use and sex work. HIV prevalence is also high

DIVERSE ASIA PACIFIC EPIDEMICS

HIV/AIDS epidemics are classified in three types:

- > **Nascent:** low-level epidemics where HIV prevalence remains below five per cent in any sub-population (for example, East Timor and Vanuatu).
- > **Concentrated:** prevalence exceeds five per cent in sub-populations—such as injecting drug users, sex workers, or men who have sex with men—but remains less than one per cent in pregnant women in urban areas (for example, Indonesia, China and Vietnam)
- > **Generalised:** prevalence exceeds one per cent of the adult population, as indicated for example by antenatal testing (for example, PNG, Myanmar, Cambodia, and Thailand).

amongst men who have sex with men, and male populations who buy sex, such as transport workers. High HIV prevalence in these subpopulations accelerates the further spread of HIV. There is an emerging pattern of HIV spread into the general population of some Asian countries, with rising HIV infection rates in women who report being monogamous. The majority of new HIV infections in most Asian countries occur through heterosexual transmission.¹ However injecting drug users

1 MAP Report 2005: Drug injection and HIV/AIDS in Asia, Map Network, 2005.

Table 1: HIV and AIDS in Asia, end of 2002 and 2004

	Adults and children living with HIV	Number of women living with HIV	Adults and children newly infected with HIV	Adult prevalence (%)	Adult and child deaths due to AIDS
2004	8.2 million [5.4–11.8 million]	2.3 million [1.5–3.3 million]	1.2 million [720 000–2.4 million]	0.4 [0.3–0.6]	540 000 [350 000–810 000]
2002	7.2 million [4.6–10.5 million]	1.9 million [1.2–2.8 million]	1.1 million [540 000–2.5 million]	0.4 [0.2–0.5]	470 000 [300 000–690 000]

Source: *AIDS Epidemic Update*, UNAIDS, December 2004.

usually have the highest HIV infection rates of any subpopulation in Asia, meaning that injecting continues to play a critical role in kick starting new local epidemics by introducing HIV into sexual networks.² Prison populations in Asia often have high HIV prevalence rates, largely associated with injecting.

Cambodia, Myanmar and Thailand have experienced the highest HIV prevalence in Asia over the last decade. More recently, provinces of southern, western and central China and states in southern and north-eastern India are emerging as new regional epicentres of the HIV epidemic. India is predicted to overtake South Africa soon as the country with the highest number of people living with HIV/AIDS globally. The large populations of China and India mean that even with low national HIV prevalence, the numbers of people living with HIV are significant. In Myanmar and Cambodia there has been significant spread into the general population and increasingly the epidemic is taking hold in rural areas. This is likely to be the longer term trend in these countries and, over time, elsewhere in the region.

Indonesia is facing the challenge of responding to rapidly expanding epidemics driven by injecting, particularly in Java, Bali and Riau as well as a major heterosexually driven epidemic in Papua Province.

In the Pacific, the situation varies. The arc of Melanesian countries share socio-cultural factors that contribute to HIV vulnerability such as high levels of sexual partnering, gender inequalities,

high rates of sexual assault, and low literacy levels.³ HIV prevalence in PNG is approaching two per cent of the adult population⁴ and Indonesia's Papua Province is experiencing similar levels. In PNG and Papua Province there are high rates of HIV among sex workers, but in the context of an expanding generalised epidemic, women and youth in the general population are also vulnerable. The epidemics in PNG and Papua Province are at a critical stage requiring urgent and focused interventions to prevent further expansion to generalised epidemics affecting a significant proportion of the population.

HIV is not evenly spread across Melanesia. Fiji is experiencing a low level but rapidly growing epidemic. Little is known about the HIV/AIDS epidemics in East Timor, Solomon Islands and Vanuatu. Although as yet relatively few diagnoses have been reported in these countries, without immediate action to address prevention and the underlying social and economic factors that drive the epidemics, there is a risk that HIV/AIDS will take a similar path in these countries as that of the more advanced epidemics in PNG and Papua Province.

Other Pacific Island countries are experiencing as yet low level, nascent epidemics driven largely by sexual transmission. Demographic factors, including the large proportion of the population aged under 25 years, combined with poor sexual health (as indicated by high rates of Sexually Transmitted Infections—STIs), labour mobility and changes to sexual behaviours, are combining to increase the

² *ibid*

³ Biological factors also play a role—for example, the absence of male circumcision has been suggested as a possible factor contributing to HIV spread in Melanesia, given that studies conducted in Africa demonstrate a correlation between male circumcision and lower rates of HIV transmission.

⁴ A 2004 PNG Consensus meeting that reviewed surveillance data estimated prevalence at 1.7 per cent of the adult population: *Report of the 2004 National Consensus Workshop of PNG*, NAC, NDoH, WHO, NHASP, 2004.

vulnerability of Pacific Island states to expanding HIV/AIDS epidemics. Seafarers and their partners (including sex workers) are populations at risk of HIV in these countries. Considerable travel occurs between Polynesian countries and Australia and New Zealand, through tourism and the Polynesian diaspora, which may also provide opportunities for HIV spread. In New Caledonia and French Polynesia, men with a history of homosexual contact represent a significant proportion of infections and throughout the Pacific there are concerns that the stigmatisation of men who have sex with men means that this mode of transmission is under reported.

There are divergent views on the likely medium-term trajectory of Asian epidemics and the rate at which they could potentially progress to mature generalised epidemics. Although it is thought unlikely that HIV/AIDS in Asia or the Pacific will follow the same epidemiological path as the hardest hit sub-Saharan African countries, it is clear that an opportunity exists to prevent further escalation. If action is not taken and epidemics affecting our neighbours spread across the general population this will have social and economic consequences that will be felt for generations.

The epidemics in PNG and parts of Indonesia are already at a level that means it is necessary to consider the implications of the future path of the epidemic for Australia's strategic, security and economic interests.

1.3 NO 'SILVER BULLET' SOLUTION ON THE HORIZON

It is highly unlikely that an effective preventive vaccine for HIV or cure for AIDS will become available in the next decade. It is probable however that in the medium term new biomedical approaches to prevention such as microbicides, advances in the use of ARVs for prevention and treatment, and the development of new monitoring and diagnostics tools designed for resource poor settings, will provide new tools for fighting the epidemic. It will be strategically important to ensure that such tools are made available to developing countries in Asia Pacific at an early stage, and are deployed so as to be cost

effective and to maximise preventive and therapeutic benefits for the populations most affected in the poorest countries. This implies the need to invest in training the health sector workforce to support the rapid transfer and uptake of new technologies.

Even with existing approaches, successes in prevention and providing treatment and care on a large scale are possible in the region. Over the last decade, strong leadership and significant domestic investment in prevention through national responses resulted in substantial reductions in the rates of expansion of HIV epidemics in Thailand and Cambodia, although maintaining these reductions may prove difficult.

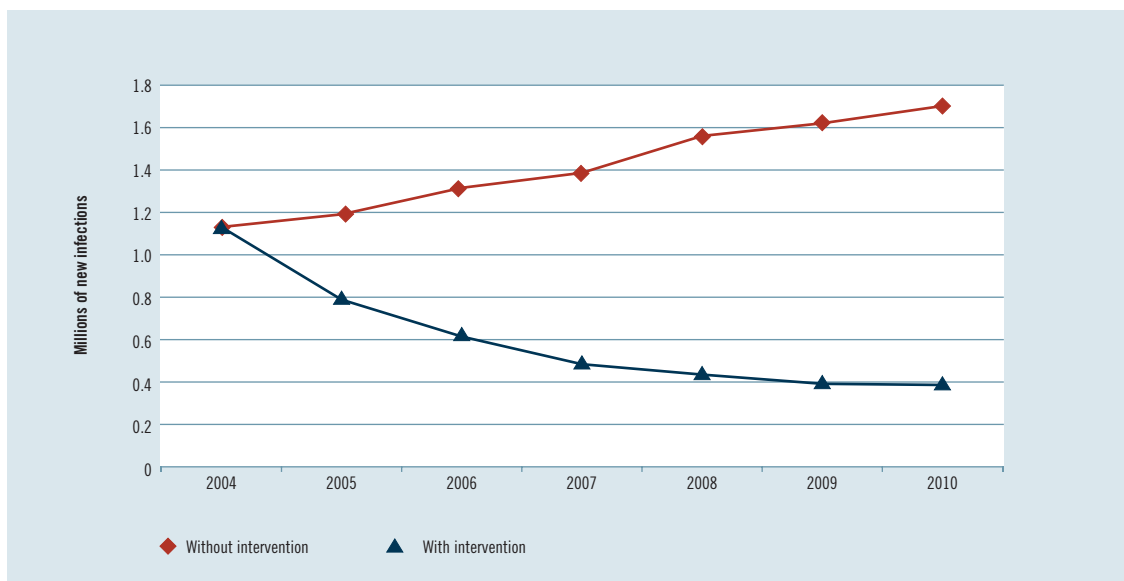
In the prevention field, achieving and sustaining behaviour change remains a daunting challenge. However certain approaches, such as well targeted community based peer education and harm reduction, can be highly effective in preventing HIV. In addition to interventions aimed at individual behaviour change, a greater focus on addressing the social determinants of vulnerability—such as stigma, gender inequalities and the social exclusion of marginalised populations—will support more effective prevention.

A key current constraint on effectiveness of prevention is the low level of national coverage of programs for the most vulnerable populations, particularly injecting drug users, sex workers, men who have sex with men, and mobile populations. Only 1 per cent of men who have sex with men, 5.4 per cent of injecting drug users and 19 per cent of sex workers were covered by HIV prevention services in 16 Asia Pacific countries surveyed in 2003.⁵

In the treatment field, advances in the scaling up of delivery of ART in middle income countries such as Thailand have been achieved within a relatively short period. Thailand's national treatment program has benefited from vigorous community sector activism and from the involvement of people living with HIV/AIDS groups in expanding the reach of clinical services and securing widespread access to locally produced generic combination ARVs through public hospitals. In 2004, 44 per cent of people

5 A Scaled up Response to AIDS in Asia and the Pacific, UNAIDS, 2005, p. 20.

Figure 1: Prevention works: Two scenarios for the number of new HIV infections in Asia Pacific to 2010



Source: Asia Pacific's Opportunity: Investing to Avert an HIV/AIDS Crisis, ADB/UNAIDS, 2004.

with advanced HIV infection were receiving ART in Thailand compared with only one per cent in Vietnam, four per cent in India and seven per cent in China. Cambodia (23 per cent) and Indonesia (24 per cent) have also achieved significant ART scale up progress.⁶ However in poorer and isolated settings delivery at scale is proving highly challenging or not occurring at all. In PNG there are as yet only a few hundred people receiving ART, yet there may be over 10 000 people who clinically require treatment.

One of the key challenges to be addressed over the next decade will be securing affordable supplies of second-line ARV medicines, as viral resistance to the drugs currently used in first-line HIV/AIDS treatment strategies grows and treatment failure becomes more common. Simplified and standardised treatment approaches, and treatment education and support to help people to adhere to drug regimens, will be important to combat the emergence of drug resistance. This is important to sustain good clinical outcomes and contain drug costs. Although treatment scale up has been assisted by dramatic reduction in prices of first-line ARV drugs over the last five years and increased

availability of fixed dose combinations, the prices offered by pharmaceutical companies for second-line regimens remain prohibitively high, exceeding \$1000 per person per year even in low-income countries.

Stigma remains a major impediment to provision of effective prevention, treatment and care responses across the region. HIV-related stigma generally arises due to the association between HIV/AIDS and taboos regarding blood, sex, death and social deviance. The people who are most vulnerable to HIV often experience multiple levels of stigma due to their status as a sex worker, drug user, or man who has sex with other men, as well as a perception that these groups are a vector for diseases such as HIV, sexually transmitted infections (STIs) and hepatitis. HIV-related stigma is a major disincentive to people presenting for testing and treatment and drives people away from prevention and care services. Strong political and community leadership including from people living with HIV/AIDS can play a critically important role in tackling stigma and discrimination (see discussion below at 3.1.1 and 3.1.5).

⁶ Ibid, p. 22.

A study of AIDS discrimination in Asia found that the most common area of discrimination reported by people living with HIV/AIDS is in the health sector.⁷ This underscores the need to educate health workers so as to challenge stigma and to address fears and misconceptions about transmission risks, as well as providing non-discriminatory occupational health and safety measures such as universal infection control precautions.

1.4 EMERGING SOCIO-ECONOMIC IMPACTS

HIV/AIDS is a development issue with its biggest impact on the world's most economically vulnerable countries. Globally, 95 per cent of people with HIV/AIDS live in developing or transition countries. The corollary of this is that no developed country has a prevalence rate above 0.5 per cent of the adult population. While the connection between HIV/AIDS and poverty is complex, with cause and effect in a macro-economic sense still unclear, HIV/AIDS is contributing to major development setbacks in many African countries.

Although the world has yet to see a country's economy collapse solely due to HIV/AIDS, the epidemic is compounding crisis situations such as food shortages associated with drought in southern Africa. Fragile economies in our immediate region such as PNG, East Timor and Solomon Islands are vulnerable to the economic impacts of an HIV/AIDS epidemic. The PNG workforce could be reduced by 34 per cent due to HIV by 2020 (Table 2).⁸

In Asia, the macro-economic impact remains unclear and there is uncertainty on the question of the virus increasing national poverty rates.⁹ Evidence suggests that HIV/AIDS has immediate micro-economic, household effects. Most HIV/AIDS related costs are borne by poor households. Individual and community vulnerability to the disease among the

poorer sections of Asian societies is likely to be confounding their efforts to emerge from poverty. Macro-economic effects solely attributable to HIV/AIDS are more difficult to determine even in high prevalence African settings. In large Asian nations with prevalence rates that vary dramatically in different parts of the country, it is more likely that economic impacts will be identified at the provincial rather than the national level. However modelling has predicted a slowing in the rate of poverty reduction due to HIV/AIDS in countries such as Cambodia and India over the period 2005–2015, delaying national achievement of Millennium Development Goals (MDGs).¹⁰

HIV/AIDS affects an economy in several ways. It strikes at people of working age; at an individual level, people living with HIV/AIDS and their families face reductions in savings and disposable incomes, and reduced household incomes are absorbed by health care and funeral costs; and AIDS-related deaths act to reduce the stock of human capital.

The economic impacts of HIV/AIDS are felt first in the health sector where care needs can overwhelm under-resourced health systems. In 2004 AIDS patients occupied more than 50 per cent of medical ward beds at Port Moresby General Hospital.¹¹ Diversion of household income to healthcare often leads to increased debt and a downward spiral into poverty. As the epidemic progresses it strains education systems, weakens demand, widens the gender gap, and potentially leads to increases in costs across all sectors of the economy.

Large-scale epidemics, such as those unfolding in PNG, Cambodia, Myanmar, and in parts of India, slow the growth of human capital. Modelling suggests that the intergenerational impacts of HIV/AIDS on human capital formation could be dramatic.¹² As HIV/AIDS strikes at the most productive segment of a society it constrains labour

7 In 2002, 54 per cent of a sample of 764 people living with HIV/AIDS drawn from India, Thailand, Philippines and Indonesia reported experiencing some form of discrimination within the health sector: *AIDS Discrimination in Asia* Asia Pacific Network of People Living with HIV/AIDS 2004.

8 Per cent reduction as compared to the workforce size estimate but for HIV: Centre for International Economics' *Potential Economic Impact of HIV/AIDS in Papua New Guinea*, AusAID, Canberra, 2002.

9 *Asia's Economies and the Challenge of AIDS*, ADB, April 2004.

10 *Asia Pacific's Opportunity: Investing to Avert an HIV/AIDS Crisis*, ADB and UNAIDS, July 2004; *The Impact of HIV/AIDS on Poverty in Cambodia, India, Thailand and Viet Nam*, ADB and UNAIDS, 2004.

11 *Report of the 2004 National Consensus Workshop of PNG*, NAC, NDoH, WHO, NHASP, 2004.

12 *The Long-run Economic Costs of AIDS: Theory and an Application to South Africa*, World Bank, 2003.

Table 2: PNG—Impact of HIV/AIDS on the main economic indicators. Deviation from baseline in 2020

	Low scenario %	Medium scenario %	High scenario %
Labour force	-13.2	-34.0	-37.5
Real GDP	-2.6	-6.8	-7.5
Real GDP per worker	12.0	41.0	47.9
Economic welfare	-5.8	-15.0	16.6
Real consumption	-2.3	-6.0	-6.6
Real investment	3.9	9.9	11.0
Exports	-0.1	-0.2	-0.2
Imports	0.7	1.7	1.9
Current account (% of GDP)	-0.5	-1.3	-1.5
Tax revenue (nominal Kina)	2.5	6.5	7.2
Budget surplus (% of GDP)	-8.8	-19.4	-20.8
Real exchange rate	-0.6	-1.5	-1.6
Urban crime	-7.2	-16.6	-18.0

Centre for International Economics *Potential Economic Impact of HIV/AIDS in Papua New Guinea*, AusAID, Canberra, 2002.

supply in key sectors, taking out society's most important economy sustaining cohorts. Absence of parental care weakens knowledge transfer and productive capacity. Early parental death reduces resources available to the family with the result that children spend less, if any, time in school building their human capital and productive potential. As the transmission of capacities and potential from one generation to the next is progressively weakened, economies may slow with effects felt only over the longer term.

1.5 ECONOMIC ACTIVITY AS A DRIVER OF ASIAN AND PACIFIC EPIDEMICS

There has been a tendency to define HIV/AIDS as a disease of poverty. Poverty contributes greatly to HIV/AIDS vulnerability and the epidemic impacts heavily on populations that are socially and economically marginalised. However it should also be recognised that in Asia Pacific there is a close association between HIV/AIDS, market growth and economic activity.

HIV epidemics in Asia Pacific are often fuelled by patterns of development. Economic development in the region has brought with it labour migration and long-distance trading. Development activity such as infrastructure projects that involve the displacement of communities,

the encouragement of migrant labour, or the development of long-distance transportation routes, can contribute to the spread of HIV.

Mining and logging sites, shipping hubs, highways, and other transport routes are settings in which risk taking occurs and in which both local and mobile populations are vulnerable to HIV/AIDS. Factors include the presence of men who are working away from their families, with disposable incomes and the coexistence of formal or informal sex industries attracted by the income generating potential of a male workforce. Of particular significance to HIV spread in Asia are patterns of black market activity that open up opportunities for movement of populations between low HIV prevalence areas and high prevalence areas. HIV spread is associated with drug routes in Central Asia, Myanmar and the Mekong, and movements of sex workers between Nepal and India.

In the Pacific, seafarers who visit sex workers in ports in higher HIV prevalence countries before returning home are at risk, as are their partners. White collar workers and their partners are also directly affected by the epidemic. The Asian economic boom has led to an increase in travel by businessmen and public servants across the region, which creates opportunities to purchase sex while away from families and for HIV to spread.

The shift from agricultural to industrial economies in Asian countries is associated with urbanisation, labour mobility and changes in land use. Increasing poverty in rural areas due to a shrinking agricultural land base forces many to migrate to the cities for work. In some Asian countries village families sell their daughters to brokers for urban commercial sex establishments, or women leave the countryside voluntarily to join the sex industry in order to send money back to their families. In China, a growing pool of tens of millions of single men on the move in search of work has been identified as a risk factor for rapid HIV spread.

1.6 GENDER ASPECTS OF THE ASIAN AND PACIFIC EPIDEMICS

Feminisation has emerged as a major feature of the epidemic in sub-Saharan Africa where the majority of new infections are in women. A similar pattern may emerge over time in parts of the region experiencing generalised epidemics such as PNG and Papua province. As the PNG epidemic matures and takes on characteristics of a heterosexual epidemic, women are increasingly infected and at younger ages than men. This is for a combination of biological factors that render women more likely to contract HIV during sex than men and social reasons such as violence against women and women's lower social and economic status.

In Asia, the pattern is very different from African epidemics and men are predominantly affected at the early stage of the HIV epidemics concentrated in injecting populations. In much of South-East Asia, including Indonesia, most infections to date have occurred in men. In Asia in 2003 there were an estimated 5.2 million men living with HIV as compared to two million women.¹³ Women will likely make up an increasing proportion of new infections in areas where the epidemic is transitioning from a concentrated to a generalised epidemic.

The economic and social impacts of HIV such as discrimination are often greater on women than men.¹⁴ Women may face difficulties accessing

treatment, care and support services due to domestic responsibilities and fear of stigma, and usually carry a greater burden as carers than men.

Economic insecurity can lead women and girls to exchange sex for goods, services and cash. Sex workers are highly vulnerable to HIV. Clients of female and male sex workers are almost exclusively male and HIV is then transmitted onwards to their wives or partners who may be monogamous. Monogamous and married women are also increasingly at risk of HIV in countries with more generalised epidemics (such as Thailand and Cambodia), because of the extramarital sexual activities of their male partners. This population of women is seldom perceived as vulnerable to HIV and is thus rarely targeted by prevention campaigns.

In PNG and the Pacific, a high incidence of violence against women and girls places them in a highly vulnerable position. Cultural and religious norms can accentuate gender inequality, and leadership from those with moral authority in society is required to change traditional social values that disempower women. Women's vulnerability is accentuated by situations of economic crisis and conflict, where gender-based violence including rape is more pronounced. Poverty imposes pressures on women and girls to provide sex in exchange for money, food or access to shelter for themselves and their families.

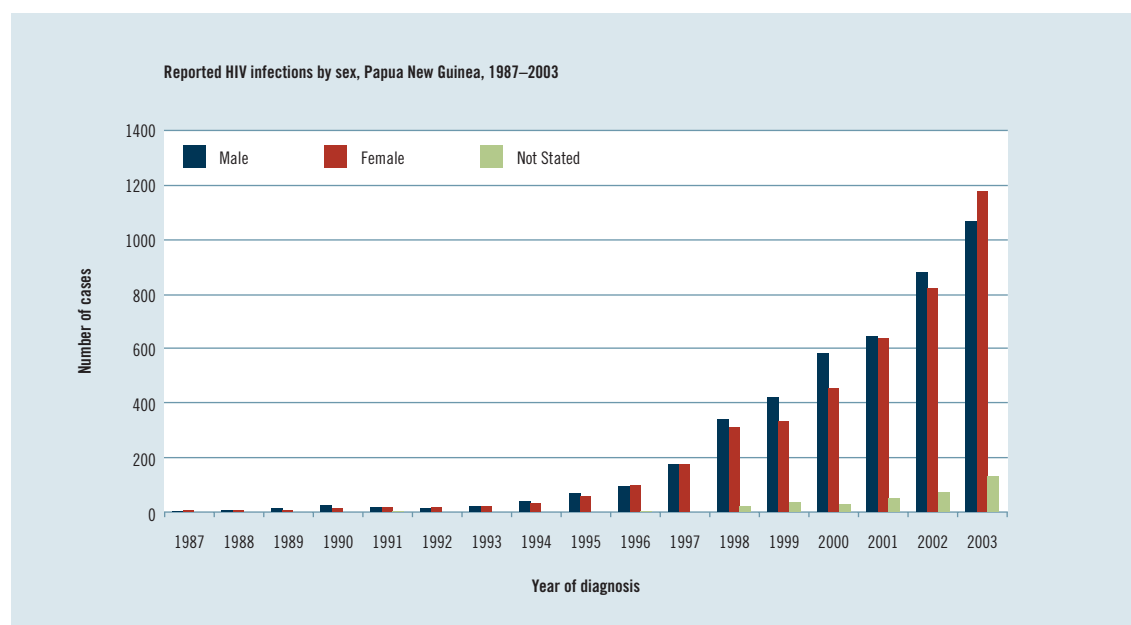
These factors underscore the need to ensure that interventions are informed by gender analysis and address aspects of women's vulnerability, as well as male social roles that contribute to HIV risk taking. Dominant gender norms and expectations and concepts of masculinity can increase men's vulnerability to HIV/AIDS as well as women's. Social norms often are that men should take risks and have frequent sexual intercourse with more than one partner. Deeply rooted expectations can lead men to insist on sex when their partners do not want it and to resist using condoms.

Transgender people are particularly vulnerable to HIV, violence and discrimination. Men who adopt transgender roles within society, such as warias in

13 *AIDS in Asia: Face the Facts*, MAP Report, 2004, p. 16.

14 Asia Pacific Network of People Living with HIV/AIDS 2004, op cit fn. 7.

Figure 2: In 2003 more PNG HIV infections were detected in women than in men



Indonesia and fa'afafine in Samoa, have specific HIV prevention and sexual health promotion needs that are rarely addressed.

1.7 RESPONDING TO GENERALISED EPIDEMICS

As the Asian and Pacific HIV/AIDS epidemics expand and affect a higher percentage of the general population (in particular women), new family and community impacts will emerge. Orphan care and support issues, paediatric treatment and care, and mother-to-child transmission issues are likely to assume greater importance in highly affected Asian countries and PNG. Some critical sectors of the workforce such as teaching, health care, and policing may experience labour shortages.

Of most significance to Australia in the next five to ten years is the escalating impact of a generalised epidemic in PNG and Papua Province, which could have highly disruptive effects on the workforce across sectors as varied as agriculture, transport, education, mining, health care, education, security, and defence. Already PNG is losing at least one teacher a week from the workforce due to HIV/AIDS related illness

and deaths.¹⁵ A generalised epidemic could also generate new population movements such as a return to villages for communal support and cross-border movements to seek care and treatment or to escape economic deprivation, creating pressure, for example, on Torres Strait health resources.

1.8 FRAGILE STATES AND SECURITY DIMENSIONS OF HIV/AIDS

HIV/AIDS presents an additional destabilising force that can compound existing social and economic inequalities and tensions, particularly in fragile and conflict affected states.

The cumulative effects of HIV/AIDS threaten stability but the impact on state functioning is gradual rather than catastrophic. Even in the countries of sub-Saharan Africa that have the highest HIV prevalence, state institutions have withstood the impacts of the epidemic. HIV/AIDS tends to have a destabilising and corrosive effect on societies and state institutions that accumulates over time. In Africa, the epidemic is creating a new phenomenon

15 National Tisa Insurance Limited estimates there will be 106 deaths among teachers in 2005, about half HIV/AIDS related: 'Teachers Dying Fast', *The Nation*, 31 May 2005.

of the undeveloping or fading state, as effective state functioning is gradually undermined and weakened.

The security consequences of HIV/AIDS in Asia Pacific are likely to be highly varied, with the social and political institutions of small countries with high HIV prevalence such as PNG likely to be the most vulnerable. In PNG and Indonesia's Papua Province, HIV/AIDS has the potential to exacerbate existing fractures in these already fragile societies.

As an additional compounding factor, these states are also highly vulnerable to sudden shocks from new communicable diseases such as SARS and avian influenza that can rapidly overwhelm health systems. Investment in health systems through workforce training and building surveillance, clinical and laboratory capacities can strengthen the preparedness of countries to respond to HIV/AIDS as well as other existing prevalent diseases and new health threats.

State fragility can accelerate the harmful impacts of an HIV epidemic. The epidemic will likely thrive where community and government responses are impeded due to weak governance systems and poorly developed health, education and social support systems. Improvements in overall governance help underpin HIV/AIDS strategies. Confidence in law enforcement, justice and the protection of individual rights are essential in providing a framework for an effective multi-sectoral response to HIV/AIDS.

In countries such as Myanmar where HIV already has a foothold, conflict can accelerate HIV spread through sexual violence, refugee flows and poor access to health and education services. The relationship between HIV and conflict is complex. Reduced social interactions during some conflict situations may result in reduced opportunities for HIV spread. However, increased HIV risks may be associated with the immediate post-conflict environment when new trade and transport systems open up but health and education systems remain weak. This points to increased vulnerability of populations in post-conflict contexts such as Bougainville, East Timor and Solomon Islands.

2 Factors shaping Australia's medium-term response

2.1 AUSTRALIA'S EXISTING INTERNATIONAL HIV/AIDS STRATEGY

Australia's strategic priorities in addressing HIV/AIDS were established by *Australia's International HIV/AIDS Strategy*.¹⁶ This strategy provides a firm foundation for planning Australia's medium-term response and sets five priority areas for action: leadership and advocacy; changing attitudes and behaviours; capacity building; treatment and care; and addressing transmission through injecting. The Strategy also commits to the principle of the greater involvement of people living with HIV/AIDS in policies and programs, and to mainstreaming HIV into all aspects of development. This Report highlights issues that require further exploration and emphasis in implementing the Strategy.

2.2 THE GEOGRAPHIC FOCUS OF THE OVERALL AID PROGRAM

The focus for Australia's efforts in addressing HIV/AIDS needs to be consistent with the overall geographic priorities of the aid program. Australia is set to remain the major donor in PNG and the South Pacific for the foreseeable future, and is a significant contributor to aid in Indonesia. In Asia, Australia is one of many donors and its aid is likely to be directed towards East and South-East Asia. In South Asia and China, where Australia's presence is dwarfed

by major donors, HIV/AIDS interventions will have to be highly strategic to make a lasting impact. In these countries AusAID should offer targeted technical assistance and work with other donors and through multilateral systems such as partnership arrangements with UN agencies.

Australia's HIV/AIDS programs should reflect an assessment of how Australia's contribution can have maximum impact by focusing on areas of comparative advantage. Geographic and strategic factors suggest the primary medium-term focus of the Australian Government's HIV/AIDS programs will be Indonesia and the Pacific, with PNG accorded top priority.

Australia's engagement in HIV/AIDS to date has included sub-regional activities (the Asia Regional HIV/AIDS Project that focuses on harm reduction in East and South-East Asia, and the Pacific Regional HIV/AIDS Project working in Pacific Island countries) and significant bilateral projects in PNG, Indonesia and China. Australia has had a lower level of engagement on HIV/AIDS in South Asia, Thailand, Cambodia, Laos, East Timor and the Philippines, and assistance to HIV/AIDS in Africa has been largely limited to Australian NGO projects. Australia has also helped finance the regional response of UNAIDS, and has committed \$75 million to the Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM).

16 *Australia's International HIV/AIDS Strategy: Meeting the Challenge*, AusAID, July 2004.

2.3 UNIQUE STRENGTHS OF AUSTRALIA'S HIV/AIDS RESPONSES IN THE REGION

Australia has played a significant role in the development of harm reduction policies and programs in Asia largely through the work of key individual experts, the Burnet Institute's Centre for Harm Reduction and AusAID-supported projects. The pragmatic approach adapted to HIV and drug use by Australian-led interventions has proved highly effective. Australia has pioneered the integration of harm reduction into the work of the health, police and law enforcement sectors in many Asian countries. Australia has also developed expertise in:

- > community based prevention interventions with sex workers and mobile populations
- > working with men who have sex with men groups, in relation to HIV prevention, community mobilisation and advocacy, particularly in East and South-East Asia
- > serological and behavioural surveillance in resource-poor settings in the region, particularly through the work of the national HIV research centres
- > ambulatory care models
- > strategic planning for HIV responses at national, provincial and sectoral levels.

2.4 AUSTRALIA'S HISTORY OF SUCCESS DOMESTICALLY IN HIV/AIDS

Australia has a highly effective domestic HIV/AIDS response. Harm reduction approaches, particularly early introduction of needle exchanges and peer education, helped prevent an injecting driven epidemic from emerging in Australia. Mobilisation of the gay community to lead prevention efforts and targeted HIV and sexual health programs for sex workers and Indigenous communities have succeeded in slowing the spread of HIV and containing the epidemic. Australia's epidemic has primarily affected gay men and Australia has developed a high level of expertise in gay men's health promotion issues. Strong political leadership on AIDS, particularly in the early years of the epidemic when stigma was high, facilitated a pragmatic approach to the issue, supported by

timely allocation of resources and establishment of a national structure for leading and managing the response.

A strength of the Australian domestic response has been the capacity to monitor and respond to trends in an epidemic that constantly throws up new prevention and treatment challenges. Australia has learnt the need for constant vigilance, to respond to new needs such as those of culturally and linguistically diverse communities, and the importance of sustained action to protect past investments.

Australia should capitalise on its significant reservoir of technical and policy development skills and expertise, and export its successes and lessons learnt (3.6.5). It would be a paradox and failure of leadership if Australia sustains a successful domestic response to HIV/AIDS whilst failing to use its expertise to mount an effective response to the epidemic in countries at our doorstep.

2.5 AUSTRALIA'S REGIONAL LEADERSHIP ROLE IN HIV/AIDS

Australia has positioned itself to play an ongoing and leading role in generating political commitment to HIV/AIDS in Asia Pacific. This has been a joint effort of government and civil society, with Australian NGOs and community groups playing an increasingly important role in contributing to HIV responses.

AusAID is the only donor that has positioned the Asia Pacific HIV/AIDS epidemic as a central priority. Efforts to date at the ministerial level have included:

- > co-founding the Asia Pacific Leadership Forum on HIV/AIDS and Development
- > convening the Asia Pacific HIV/AIDS and Development Ministerial meetings in 2001 and 2004
- > championing HIV/AIDS at APEC and UNESCAP
- > supporting the development of a Regional Strategy on HIV/AIDS for the Pacific through the Secretariat of the Pacific Community (SPC)
- > a capacity building partnership initiative linking Australian national professional and community sector peak organisations with similar groups in

the region (Australian HIV/AIDS Partnership Initiative—AHAPI)

- > support to regional networks working in HIV/AIDS in Asia Pacific through the ‘7 Sisters’ initiative
- > a sub-regional initiative to provide research evidence to support stronger political action on HIV/AIDS involving Indonesia, East Timor and PNG flowing from the South-West Pacific Dialogue
- > laying the foundations for a business leaders initiative on HIV/AIDS in Asia Pacific.

The Australian Government actively promotes the unique needs of the region through multilateral processes such as monitoring the achievement of targets established in the UNGASS Declaration of Commitment on HIV/AIDS (2001).¹⁷ The Australian Government should continue to advocate the needs of the region through its position on the UNAIDS Programme Coordinating Board, membership of the GFATM Board, attendance at World Health Assembly and World Bank meetings, and through input to the Commission on Narcotic Drugs, Commission on Status of Women, Commission on Human Rights, and at other multilateral high level meetings.

Australian support for, and involvement in, the biannual Asia Pacific AIDS Congresses (ICAAP) recognises the importance of the event as a vehicle for raising the profile of the issue, encouraging leadership and sharing policy, program and research learning.

2.6 A CROWDED ENVIRONMENT OF BILATERAL AND MULTILATERAL PLAYERS

Over the last five years HIV/AIDS has become a high priority for most of the major donors active in Asia Pacific. With the establishment of the Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM), the United States Government’s President’s Emergency Plan for AIDS Relief (PEPFAR - in Vietnam), expansion of DfID’s

HIV/AIDS programs (particularly in South Asia), and increased investments by the World Bank and Asian Development Bank in HIV/AIDS there are significant resources available for fighting HIV/AIDS in the region. There is also a multitude of NGOs now active in HIV/AIDS in Asia and the Pacific.

Major issues currently include:

- > the lack of absorptive capacity to use available funds effectively
- > lack of coordination of investment by donors and multilateral agencies, leading to duplication and overburdening of staff in complying with the requirements for funds management set by multiple donors
- > accountability burdens experienced by countries as a result of multiple monitoring and evaluation requirements set by donors that result in multiple processes with different timelines.
- > NGO coordination—between diverse NGO programs and with other donor and domestic activities
- > NGO competition for funds, hampering cooperation and capacity to provide national advocacy and influence national policy.

The multiplicity of players involved in HIV/AIDS contributes to fragmentation of the international effort. Coordination and alignment are desirable but may be difficult to achieve because of entrenched historical roles or irreconcilable priorities and approaches dictated by domestic political considerations such as willingness to engage with legally marginalised populations.

Australia is a strong supporter of closer coordination on the basis of the Three Ones principles¹⁸ that were agreed by donors and UNAIDS in 2004. Australia is working with UNAIDS to support harmonisation of efforts and is working within the framework of the recommendations of the *Global Task Team Report on Improving AIDS Coordination among Multilateral Institutions and International Donors* (UNAIDS 2005). It is recognised that institutional capacities, needs and progress in implementing the Three

17 Progress in achieving targets established by the UNGASS Declaration of Commitment is to be reviewed by the UN General Assembly in June 2006.

18 One agreed HIV and AIDS action framework that provides the basis for coordinating the work of all partners; one national AIDS coordinating authority, with a broad-based multi-sector mandate; one agreed country-level monitoring and evaluation system.

Ones differ between countries and that fragile states pose additional challenges. In PNG and Pacific Island countries where Australia is the major donor, Australia should play a lead role in harmonisation efforts.

2.7 WHOLE-OF-GOVERNMENT ASPECTS OF THE AUSTRALIAN RESPONSE

Because of the epidemic's profound implications for core social and economic factors for Australia and the region, there is a need to ensure a significantly greater understanding within Australian government agencies of the potential impact and threats of HIV/AIDS. That understanding should be translated into a coherent approach, similar to other whole-of-government approaches which maximise Australia's comprehensive response through exploiting the strengths of individual agencies. Given the current involvement of a number of agencies in significant regional diplomatic initiatives (for example, the Enhanced Co-operation Program in PNG and RAMSI in Solomon Islands), there is a framework which can be used to develop or strengthen a comprehensive government approach through and complementary to Australia's aid program. Underscoring the importance of this approach is the direct role some of these agencies can play in helping to stem the spread of HIV/AIDS in the region.

This role can take the form of an enhanced focus on prevention work with high risk groups. For example, through the Australian Defence Force's co-operation activities, increased awareness raising and behaviour change can be incorporated into their capacity building work with other defence forces in the region, a number of which are recognised as high-risk groups within their own communities. Similarly, the work of Australian Federal Police (AFP) in the region should include a comparable prevention-focused approach—again because of the high-risk nature of some of the region's counterpart police forces.

The transboundary nature of HIV/AIDS requires the involvement of the Department of Health and Ageing not least because of responsibility in its resourcing of national organisations that play a role in regional as well as domestic responses—such as

Australasian Society for HIV Medicine (ASHM), Australian Federation of AIDS Organisation (AFAO), and National Association of People Living With Aids (NAPWA)— and the Department's role in providing Torres Strait health services and Medicare arrangements, participating in the APEC Health Taskforce, participating in bilateral partnerships with health ministries, and liaising with WHO. State health departments also need to be considered as part of a broader response framework, particularly where there are actual or potential links between state health agencies and developing countries (such as Queensland Health's role in providing services to PNG citizens in Torres Strait).

Overarching specific responses are broader development issues related to HIV/AIDS. As the Australian Government's agency of development aid expertise, AusAID remains central in providing policy co-ordination, and providing expertise in building capacity and monitoring and evaluating the impact of HIV/AIDS interventions.

3 Priorities for action 2005–2015

3.1 BUILDING LEADERSHIP MOMENTUM

3.1.1 HIV/AIDS AS A POLITICAL CHALLENGE

The success of HIV/AIDS responses in the region will be determined by action in the political sphere. This is more critical to reversing the spread of HIV/AIDS than action within any single sector. Leadership requires convincing prominent people in political life and civil society, including faith based groups and the business sector, to respond seriously and scientifically to HIV/AIDS. This is particularly challenging in communities where HIV/AIDS is thought not to affect the mainstream of society and indeed may as yet be largely restricted to populations that may be perceived as undesirable such as sex workers, drug users and men who have sex with men.

A common characteristic of these marginalised groups is that their behaviour is criminalised in most Asia Pacific countries, which adds a further dimension to the stigma of these populations and makes them difficult to reach with prevention and care programs (see 1.3 above). Leadership requires action to lead communities through difficult debates regarding controversial issues—to reshape community norms regarding sexuality, the legal status of vulnerable populations and the status of women in society. This is inherently difficult and requires skills and determination to navigate politically risky terrain.

National leadership on these issues needs to be driven at a high level, with the prime minister's office or equivalent taking direct responsibility for multi-sectoral coordination mechanisms for HIV/AIDS policies and programs. Leadership on HIV/AIDS needs to occur at local, district and provincial as well as the national level. National governments in some large Asian countries do not have the influence to drive agendas at provincial and district levels. Implementation of programs is often the responsibility of provincial and district administrations that may be insufficiently informed about HIV/AIDS. AusAID's country strategies need to therefore consider how action on HIV/AIDS by all levels of government can be supported.

Civil society, organisations of people living with HIV and AIDS, community based groups, NGOs, the medical and scientific community, faith-based organisations, businesses, and the media all have important roles to play in creating a demand for better leadership and in holding governments accountable. These groups require support to raise awareness, advocate needs, disseminate information, and stimulate debate.

Australia has positioned itself as having a central role in promoting leadership on HIV/AIDS in the region through the combined efforts of Australian Government and civil society. The capacity of key players in the Australian HIV and development sectors to support leadership from within Australia on the regional epidemic will be

enhanced if a mechanism is established whereby civil society can provide ongoing advice to the Australian Government on policy and strategy issues. Consideration should be given by AusAID to establishing such an advisory mechanism.

3.1.2 BUILDING ON THE ASIA PACIFIC LEADERSHIP FORUM ON HIV/AIDS AND DEVELOPMENT

Leadership initiatives taken to date such as the Asia Pacific Leadership Forum on HIV/AIDS and Development (APLF) have so far only been partially effective in mobilising the political will and resources required to mount an effective response. Building on the APLF's achievements, new models and approaches are required to support sustained national and regional leadership on HIV/AIDS and to develop a more systematic, high-level approach to leadership that encompasses civil society as well as government roles. Australia should continue to work in partnership with UNAIDS to build leadership in the region, and this should be supported by stronger direct working relationships between APLF and the Australian Government through AusAID, the Department of Foreign Affairs and Trade (DFAT) and relevant ministerial staff.

A priority should be accorded to building high-level commitment from political, business and religious leaders to comprehensive HIV/AIDS responses, especially in PNG and other Asia Pacific countries in which leadership on the issue is at best mixed but often invisible. Efforts need to focus at the country level and target countries where leadership on HIV/AIDS is weakest.

The Australian Government can also engage regional fora and sub-regional agencies such as the Association of Southeast Asian Nations (ASEAN), Pacific Forum meetings and the Secretariat of the Pacific Community (SPC) to support leadership on HIV/AIDS. On the global stage and through multilateral processes, Australia will need to continue to promote the distinctive nature of the Asian, PNG and Pacific HIV/AIDS epidemics. This includes needs that arise from the social, political and geographic characteristics of these subregions.

3.1.3 EVIDENCE TO SUPPORT LEADERSHIP

Leadership initiatives need to be based on sound political analysis, drawing on academic expertise in political sciences that supports a deeper understanding of political cultures in the region. Pathways of political influence on HIV/AIDS and development need to be understood. Within Government, the most appropriate ministers, advisers and senior bureaucrats need to be identified and supported in advocating the issue. This needs to encompass not only key personnel in the health portfolio but also other ministries including, critically, finance and the prime minister's office or equivalent.

Leadership also needs to be informed by experience of what works in persuading people to give higher priority to HIV/AIDS, in reducing stigma and in improving the social environment for people living with HIV/AIDS and affected communities. It may be important to define a metric of success against which progress in preventing escalation of the epidemic can be measured, for example by using a standardised prediction for each country in the region of the level that new HIV infections will rise to if no action is taken in a given period (Figure 1).

Effective leadership can be supported by establishing an incentive structure in which leaders are persuaded that the long-term benefits of engaging in the fight against the epidemic outweigh the short-term costs and political liabilities associated with championing what may be perceived as an unpopular cause. Leaders need to be persuaded of the necessity of acting on the basis of accurate medical, economic and social research evidence. Consideration of evidence of effectiveness can rapidly shift opinions by appealing to pragmatic political interests, such as the poverty and stability impacts of HIV/AIDS. Experience of harm reduction programs in Asia is that attitudes can, over time, be changed when evidence of effectiveness in reducing infections and the social and economic costs associated with HIV/AIDS is demonstrated.

Especially in the early stages of an epidemic, leaders will be more readily convinced to invest resources and attention to HIV/AIDS if they understand the epidemiological characteristics of HIV. This includes

the long period of latency, the way it can spread explosively in vulnerable populations and then more broadly throughout the whole population, its incurability, the complexity of treatment, and the way HIV/AIDS interacts with and compounds the impact of other prevalent diseases.

The Australian Government should work with other donors and UNAIDS to ensure that political and civil society leaders in the region who are committed and effective in championing HIV/AIDS are supported. People or organisations that stand in the way of effective leadership on HIV/AIDS (due to religious or customary constraints, for example) need to be identified and their opposition negotiated so as to shift opinions.

To support its programs on leadership, AusAID should adopt a more systematic approach to drawing on political science expertise relevant to the region from Australia and internationally, including the expertise that exists outside of the HIV sector.

3.1.4 PARLIAMENTARIANS

Parliamentarians are a key target group for leadership programs. Levels of basic knowledge about HIV/AIDS amongst parliamentarians are often low. Ministers working across diverse portfolios need to be educated on the nature and multisectoral impacts of HIV/AIDS and supported in advocating improved responses. Ministers responsible for issues such as rural development, crime and justice, trade, transport, and migration need to appreciate the potential effects of the epidemic on their areas.

Parliamentary groups provide a process for improving understanding amongst political elites and for identifying potential champions. Australia should support the development of regional parliamentary groups to support education of and by parliamentarians on HIV/AIDS and related issues such as sexual and reproductive health. Australia's own Parliamentary Group on HIV/AIDS should be supported in taking a more active role in raising the profile of issues surrounding the regional epidemic and in engaging with regional parliamentarians.

Action at the foreign ministerial level has been key to Australia positioning itself as a regional leader in HIV/AIDS responses. The ongoing engagement of the Minister and Parliamentary Secretary of DFAT in HIV/AIDS issues needs to be supported by the actions of leading diplomats, including ambassadors and high commissioners in the region and diplomatic staff engaged in multilateral discussions and debates. Australia needs to ensure that diplomatic staff are well briefed on HIV/AIDS and development, and equipped to play leadership roles for improved HIV/AIDS responses.

3.1.5 COMMUNITY SECTOR LEADERSHIP

Building community sector leadership involves supporting advocacy groups representing vulnerable populations such as injecting drug users, sex workers and men who have sex with men. Identifying and supporting representatives of these communities to contribute to national HIV/AIDS responses is a vital part of leadership. Community based organisations contribute to leadership through advocacy, innovation and a watchdog role. Supporting links between community based advocacy groups throughout the region, including Australian organisations, can help build leadership capacity.

Australia's International HIV/AIDS Strategy commits to the principle known as GIPA—the Greater Involvement of People Living with HIV/AIDS—in all levels of decision making regarding policies and programs. This is important because of the knowledge and experience about the epidemic people living with HIV/AIDS bring, and also because their involvement helps ensure that people living with HIV/AIDS have confidence in and cooperate with decisions on policy and program options. Public involvement of people living with HIV/AIDS also helps break down stigma. Enabling people living with HIV/AIDS to adopt leadership roles, including through funding regional and national organisations and networks of people living with HIV/AIDS, is crucial to support peer based mobilisation. Governments need to provide a supportive environment in which people living with HIV/AIDS can participate in shaping national responses.

3.1.6 EMPLOYERS AND BUSINESS SECTOR LEADERSHIP INITIATIVES

The resources of the business sector should be harnessed to meet the epidemic's escalating demands. The capacity of this sector to influence the course of the regional epidemic through its own activities and influence on other players has been largely overlooked to date.

Business is already playing a significant role in responding to HIV/AIDS in Sub-Saharan Africa. In Asia Pacific, the spread of HIV/AIDS is associated with economic activity and it is crucial to engage employers to support responses that address employee needs and to contribute to addressing the prevention and care needs of the broader community. In much of Asia the ready supply of labour means employers may not consider that HIV/AIDS poses a direct threat to workforce productivity. However business leaders need to understand the potential medium- and long-term impact HIV/AIDS will have on their businesses as a result of depletion of markets and increasing costs such as health care payments, insurance premia and training expenditures for skilled labour. Employer and labour organisations should be targeted, and greater use should be made of the regional International Labour Organisation (ILO) office in supporting business responses to HIV/AIDS.

Business leaders in key sectors such as media and mining also influence national political priorities and it can be effective to target business leaders to ensure HIV/AIDS is placed higher on political agendas. Lessons can be learnt from the work of national business initiatives on HIV/AIDS that have been established in Asian countries such as China and Thailand and the Asian Business Coalition on AIDS, which supports workplace programs in several countries in the region. A greater level of engagement is required, and the Australian Government should support a coordinated response to the regional epidemic from the Australian business sector. Australian businesses active in the region should be encouraged to adopt HIV/AIDS policies drawing on resources and experiences from the region.

3.1.7 HIV/AIDS AS A CORE DEVELOPMENT ISSUE

Australia's *International HIV/AIDS Strategy* commits AusAID to mainstreaming HIV/AIDS across its development cooperation activities. Beyond this, at the policy level, Australia needs to encourage counterpart governments of aid recipient countries to mainstream HIV/AIDS within their own policies and programs. This implies a conscious political choice to recognise HIV/AIDS as a key issue to be addressed in all development strategies aiming at economic growth and poverty alleviation. Mainstreaming HIV/AIDS across governments can only be achieved through political action. For mainstreaming to work, the finance and planning ministries controlling budgets and negotiating terms of foreign assistance must be encouraged to make HIV/AIDS a priority.

Mainstreaming efforts should adapt core business of sectors to the realities of HIV/AIDS, drawing on the comparative advantage of each sector in addressing different aspects of the epidemic and its social drivers such as poverty, gender inequalities, and violence. Mainstreaming should not necessarily involve all ministries or sectors, but should first focus on priority ministries and sectors relative to the transmission dynamics in each country. For example, in countries where drug use and sex work are major drivers of the epidemic, engaging justice, prisons, police, and social welfare sectors should be a priority.

To ensure that Australia's aid program incorporates HIV/AIDS-related development issues into the breadth of its bilateral work, the linkages between development and HIV/AIDS need to be woven into respective country strategies and approaches regardless of the presence or not of a specific HIV/AIDS activity. As a major development challenge, this recognition needs to be a core element of each country strategy and preferably in the form of an individually crafted approach that accounts for local priorities and the mainstreaming activities of other donors.

3.1.8 GOVERNANCE INITIATIVES TO UNDERPIN HIV/AIDS RESPONSES

Improvements to governance structures and training and support on implementing good governance principles are important for providing the foundation for effective national HIV responses. Good governance is important for creating an 'enabling environment' for effective programs. Australia should support the building of transparent, accountable and participatory health and community services in developing countries as essential elements of an effective HIV/AIDS response. Institutional capacity building in the health and education sectors and improved accountability for HIV related investments to minimise corruption in procurement activities are essential for effectively delivering HIV/AIDS programs.

Investment in governance programs enhances the capacity of governments to respond to HIV/AIDS through sound functioning institutions that support leadership and transparent decision making. Robust HIV/AIDS responses require processes by which society can discuss the health aspects of sex and drug use openly, and talk about condoms, injecting and sexual transmission of infections. Governance needs to include creating accountable HIV-specific mechanisms such as national AIDS councils. More generally, HIV responses will be supported by healthy democratic institutions and a free press to facilitate open dialogue, a strong and pluralistic civil society, freedom of expression and association, and an impartial and effective legal system. If HIV-affected communities cannot organise freely, register their associations, and deliver education to peers without fear of persecution, they will be driven underground and the chances of mounting an effective public health response to HIV/AIDS will be reduced.

Good governance means competent management of a country's public health and education resources in an open, transparent, accountable, and equitable manner which responds to peoples' needs. Good governance is critical to supporting community mobilisation and to meeting the political challenge of prioritising HIV/AIDS in government policies and programs. Fostering the development of civil society

includes supporting community organisations such as women and youth groups and community media.

The architecture of HIV/AIDS policy and program development, such as national and provincial AIDS committees and planning mechanisms, will not function effectively without good governance principles. Community based responses to HIV/AIDS rely on effective mechanisms and institutions through which HIV affected groups can articulate their needs and legitimately influence allocation of resources, such as functioning national coordinating authorities and other consultative and advisory bodies. The HIV/AIDS response will also be strengthened by developing approaches in related policy areas such as drug control and law enforcement that encourage the involvement of affected communities in debates and decisions, allowing assessment of the potential HIV/AIDS impacts of policy choices.

Populations such as sex workers, illicit drug users and men who have sex with men may be held back from participating in planning and policy development because of fear of discrimination and legal repercussions. In some Asian countries these groups are unable to form associations or express their needs openly. The character of the epidemic is such that individual behaviour change and the transformation of social norms regarding sexual and injecting behaviours lie at the core of prevention. It is difficult, if not impossible, to secure these through coercion. Protection of the human rights of marginalised populations is essential to ensure these populations have trust and confidence in health authorities, come forward for testing, and access prevention, treatment and care services without fear of discrimination, police harassment or arrest. Anti-corruption and governance programs that make police more accountable may lead to more women reporting incidents of violence and more effective police responses to gender based violence.

Stigma is a major impediment to greater involvement of people living with HIV/AIDS. Very few people living with HIV/AIDS from Pacific or Asian countries are in a position to play a public role in the fight against the disease. In the few cases where marginalised populations have organised representative groups and become effective in

influencing national policy (as in Thailand) this has tended to be through effective advocacy and use of media rather than a government facilitated process. Governments do not always accept or appreciate the important role people living with HIV/AIDS can play in contributing to policy development and planning.

The Three Ones principles provide a framework for strengthening country-led responses, but progress towards implementation is patchy in the region. In PNG, the National AIDS Council and Provincial AIDS Committees have been under-resourced and unable to operate effectively—central Government leadership has been mixed on HIV/AIDS and there is planning confusion. Indonesia needs to build a more robust central national coordinating mechanism for policy development relating to, and planning of, a country-wide response. In the Pacific, national coordinating authorities often struggle to maintain profile, political support and clarity of purpose.

The advent of GFATM has been welcomed but has added an extra level of complexity to governance arrangements. New GFATM structures such as Country Coordinating Mechanisms (CCMs) have not worked well in some Asian countries, although they generally provide scope for more participatory approaches. In PNG and the Pacific concerns have been raised that CCMs could duplicate national AIDS council functions. CCMs should be better harmonised with other structures.

The danger is that one-size-fits-all, inflexible models are unlikely to work in all national contexts. In some countries, national multisectoral councils or commissions and CCM processes may diffuse central government focus on HIV and marginalise the health sector at a stage in the epidemic when a robust health sector response may be critical for establishing surveillance and health workforce capacity. The role of the health sector should be enhanced, while simultaneously strengthening other sectors to play a role in the national HIV/AIDS response such as police and education, as well as civil society and private sector responses.

3.2 PREVENTION

3.2.1 PREVENTION IS FOR LIFE: COMPREHENSIVE AND SUSTAINED APPROACHES

The global consensus is that, to be effective, country responses to the prevention of HIV must include a comprehensive range of policies and programs.¹⁹ The response should include expanded access to condoms, education including by peers to address sustained behaviour change and combat stigma, harm reduction measures such as needle exchanges and drug substitution programs to address transmission through injecting drug use, programs addressing gender issues, STI treatment services, primary prevention for pregnant women, parent-to-child prevention programs, blood safety measures, and infection control in health care settings. Concentrated epidemics like those in much of Asia among sex workers, injecting drug users and men who have sex with men are eminently preventable at relatively low cost through well targeted interventions.

In the context of predominantly sexually driven epidemics such as those in PNG and the Pacific, aspects of HIV prevention should be integrated with sexual and reproductive health services and programs to address gender violence and sexual coercion. High STI rates significantly accelerate HIV epidemics. The presence of an STI can significantly increase the likelihood that a person will acquire and transmit HIV. STI testing and treatment services, and related education and sexual health promotion, are extremely important and often highly cost effective interventions for HIV prevention.

To respond to rapidly expanding epidemics, HIV prevention must be given a consistent, high-level focus. HIV prevention will not succeed on the basis of one-off awareness campaigns. Sustained prevention strategies must be multi-pronged and well targeted, involving and engaging communities at higher risk and people living with HIV/AIDS to review and renew educational messages to ensure that these messages work for vulnerable

19 UNAIDS Policy Position Paper: *Intensifying HIV Prevention*, June 2005.

populations. Where HIV epidemics are nascent but likely to develop quickly unless immediate action is taken—as in Solomon Islands, Vanuatu and East Timor—there is a strong case to intervene with highly targeted prevention interventions. These need to be supplemented by interventions that address structural and contextual causes of vulnerability, such as income disparities and social exclusion of marginalised populations. To build a sustainable response, communities need help to identify the problems, skills and resources required to respond to the causes and impacts of HIV/AIDS.

Stigma and discrimination constitute a major barrier to effective prevention across the region and AusAID should identify opportunities for reducing these through its programs. For example, training for health care workers, teachers, prison staff, and drug rehabilitation personnel should include education to reduce stigma.

Integrating HIV, drug use and sexual health education into the curriculum of formal education systems (through life skills and healthy lifestyles) is a cost-effective way to reach young people in school. Education sector programs should be required to mainstream HIV/AIDS, to ensure that the education workforce is HIV/AIDS literate, that teachers are trained in HIV and sexual health education methodologies, that there is a non-discriminatory educational environment for teachers and students living with or affected by HIV/AIDS, and that there is access to accurate and appropriate teaching resources. Strategies for working with out-of-school youth in other settings, including culturally and faith-based youth groups, are also required.

3.2.2 COMMUNITY MOBILISATION TO UNDERPIN PREVENTION

Priority should be given to expanding HIV programs for populations at increased risk in Asia Pacific. Governments often have little expertise and minimal credibility in changing community values in areas of intimate personal behaviour, including sex and drug use in socially and legally marginalised populations. Therefore community mobilisation for prevention is necessary through NGOs and community groups representing affected populations. HIV affected

communities such as sex workers, drug users and men who have sex with men can play an important role as peer educators and advocates for prevention. Visibility and participation of people living with HIV/AIDS in prevention is also crucially important. Efforts to combat stigma and discrimination affecting these groups will support their involvement in prevention. Community activism can ensure high levels of support for, and uptake of services by, affected communities. The energy of these groups needs to be harnessed to greater effect. However, across the region the capacity of civil society groups to participate in debates and decisions regarding national and provincial HIV/AIDS responses is often limited by resource constraints, and lack of a well defined role.

In many countries in the region, community mobilisation is impeded by legal and political constraints or lack of a strong indigenous community based sector within which HIV programs can be located. Some countries in Asia have single party systems and civil society is restricted in its influence on government policy. In many Pacific countries and PNG there are few community based groups able to play a role in prevention outside of the Church sector, which is likely to remain central to the community response. Investment in capacity building for community based groups and promotion of policy reform to support growth of a vibrant community sector are important to underpin effective prevention with poor and marginalised populations.

Developing effective HIV responses requires engagement of government and civil society with complex, controversial and sensitive issues. In Australia and other countries that have mounted successful HIV responses, policy development and program implementation has been supported by vigorous political and community debate. Community organisations in Thailand and Indonesia are already important players in shaping the national response in their countries and more recently in China and Vietnam new civil society groups have emerged that are advocating needs to government and mobilising communities to expand the response.

Greater use needs to be made of new communication tools and technologies. The media, for example, can develop novel communication approaches for

HIV prevention such as narrowcasting of targeted messages to specific populations. Prevention strategies need to be informed by an understanding of the political environment that dictates what is culturally acceptable. Political decisions regarding HIV prevention and vulnerable populations are sometimes not made on a rational basis. To address this, new media can be used to educate about the realities of HIV/AIDS and to promote an evidence-based approach whilst working within contextual constraints and political realities.

3.2.3 HARM REDUCTION

Australia should support comprehensive harm minimisation frameworks that address illicit drug use through a range of measures that encompass demand and supply reduction, as well as harm reduction for HIV prevention.²⁰

Harm reduction measures such as needle exchanges, peer education and outreach to injecting drug users have been highly effective in HIV prevention. Harm reduction approaches should be part of a broader set of approaches appropriate for health promotion and illicit drug use prevention (which includes the full range of treatment programs—including drug substitution treatment and abstinence based programs, and equitable access for drug users to education, testing and treatment services for STIs and HIV, preferably in a context of accessible primary health care). Drug substitution programs—such as methadone or buprenorphine maintenance—can be highly effective for HIV prevention in resource poor settings, due to the reduction in HIV transmission that results from reducing injecting, and the opportunities for counselling and education. Programs addressing HIV and illicit drug use should recognise that people who use drugs have complex prevention, care and support needs that should be addressed to reduce drug related harms to individuals, their families and communities.

Australia has a strong track record in harm reduction programs in South-East Asia and China and plays a leading role internationally in drug control and harm minimisation policy and programs. Australia has

also been highly successful in engaging the police and justice sectors to work with the health sector to deliver harm reduction programs in countries such as Myanmar, Vietnam, China, and Indonesia. This approach should continue. Neglected areas requiring greater priority include preventing HIV in prisons and addressing the role non-injectable drugs such as amphetamines, cannabis and alcohol play in HIV transmission. Alcohol plays a major role in the incidence of sexual violence in many Pacific Island communities.

In the harm reduction field Australia risks becoming a minor player if it concentrates only on program funding. Program funding and promoting good practice are important, but it may be more strategically significant to concentrate on expanding Australia's role to providing technical assistance on harm reduction and other aspects of illicit drugs policy and programming. Australia has high levels of technical expertise in training and capacity building for drug policy development, education and information, demand reduction, and drug treatment. Work with national authorities on HIV prevention among people who use illicit drugs can also result in strengthened partnerships with those responsible for narcotics control and other related transnational issues such as terrorist networks, people trafficking and arms trafficking.

Australia is also in a key position to assist in the development of policies that reduce the impact of the HIV and drug epidemics in Asia by integrating responses to HIV and drug use with broader development goals and processes. Consideration needs to be given to the impact of broader strategies for social and economic development on the prevention or amelioration of vulnerabilities to illicit drug use. Awareness of the role that social and economic development processes can play in creating or worsening vulnerabilities should inform development thinking. Through its involvement in harm reduction and law enforcement capacity building in the region, Australia is well placed strategically to advocate the need to link these agendas, provide forums for their development and model them in action.

²⁰ *Australia's National Drugs Strategy: Australia's Integrated Framework 2004–2009* defines a conceptual model that positions harm reduction alongside supply and demand reduction efforts as three components of a broader 'harm minimisation' framework.

3.2.4 ENABLING LAW AND POLICY ENVIRONMENT FOR PREVENTION

An essential component of successful prevention is an enabling and supportive policy and legislative framework. A common issue faced in the region is the lack of a regulatory environment to support ready access to prevention technologies, including condoms, lubricant and needles and syringes, especially in high-risk settings where sexual activity and injecting are commonplace. Laws that criminalise behaviours of sex workers, drug users and men who have sex with men may need to be amended to ensure HIV prevention and health promotion services are provided without risk of prosecution or police harassment. Law and policy reform are also important to ensure a non-discriminatory environment for people living with HIV/AIDS and for vulnerable populations that experience stigma.

Australia has developed internationally recognised expertise in regulatory approaches and reform to criminal and public health laws in areas such as testing and notification, contact tracing, confidentiality, discrimination, occupational health and safety, sex industry regulation, quality control of condoms, and regulation of the distribution of needles and syringes. Australia has experience in drugs policy frameworks that encompass HIV prevention through pragmatic and humane approaches. Australia should capitalise on its capacity to offer technical assistance in legislative and regulatory frameworks for HIV/AIDS. Australian expertise enabled PNG to enact model HIV/AIDS legislation.²¹

3.2.5 PREVENTION IN THE AGE OF ANTIRETROVIRAL THERAPY

Australia should continue to support a balanced approach to allocating resources to treatment and prevention. These are closely interrelated and should be positioned as elements of a continuum of interventions.

In low prevalence countries such as Pacific Island states, prevention should be an overall priority. However, with low patient caseloads universal ARV treatment is affordable and should also be available. The availability of ART has been shown to strengthen the prevention response in some settings such as Haiti and South Africa. The availability of ART and care and support services can help break down stigma and provide a strong incentive for people to seek HIV testing and to access behavioural counselling and advice. People diagnosed with HIV are an important target population for prevention education. Information and peer education about safe sex and drug use for people living with HIV/AIDS form an important part of a comprehensive prevention approach. Care and support provided to people living with HIV/AIDS helps provide a supportive environment for prevention work.

Scaling up treatment, care and prevention—as opposed to focusing on only one aspect—will lead to greater benefits in reducing new infections and averting deaths. Epidemiological modelling shows that expanding care activities with prevention in a comprehensive manner can dramatically reduce the resource needs for treatment over the long term. Treatment makes prevention more effective, while prevention makes treatment more affordable.²²

For populations experiencing high HIV infection rates treatment access provides new opportunities for HIV prevention as a result of the increased accessibility of affected groups to health promotion services. When ARV treatment is taken up broadly in an affected population there are also preventive benefits due to the lowering of the level of virus circulating in the community (community viral load).

However, the availability of treatment may also have a negative impact on prevention, particularly if resources are diverted from community based prevention programs to fund testing and treatment. Improved access to treatment is sometimes associated with an increase in risk taking behaviour since some people at risk may assess unsafe sex as carrying less personal risk. This underscores the

²¹ HIV/AIDS Management and Prevention Act 2003, PNG.

²² Salomon, J et al 'Integrating HIV prevention: from slogans to impact', *PLoS Medicine*, Vol 1, Issue 2, January 2005.

need to maintain vigorous prevention programs to forestall an increase in risk taking. Another risk associated with treatment scale up is that prevention services are increasingly located in clinical settings. Although there are benefits associated with integrating some prevention services with testing and treatment services (for example, to reach newly diagnosed people), this should not detract from the need to expand prevention services such as peer education and access to condoms and clean needles in a variety of accessible, non-clinical community settings.

ARV availability is also essential for effective mother-to-child transmission prevention (PMTCT) programs and for providing post exposure prophylaxis (PEP). Australia has technical expertise in administering ARVs for PMTCT and PEP. This expertise should be used to implement PMTCT programs targeted to the most vulnerable groups, and PEP for those who may have been exposed to HIV (such as survivors of sexual assault and health care workers in resource poor settings).

3.2.6 DEVELOPING AN EVIDENCE BASE FOR EFFECTIVE PREVENTION

Prevention resources must focus primarily on populations where infections are occurring. HIV surveillance is critical to ensure that prevention investments are appropriately targeted. Lack of capacity to track the path of the epidemic through timely serological and behavioural surveillance is a common issue for all Asia Pacific countries. Prevention needs to be informed by improved surveillance and social research, including behavioural, sociological, ethnographic and political research.

Evidence of effective behaviour change interventions in specific cultural settings is a priority. Australian expertise in epidemiology and behavioural sciences should be better used to respond to regional epidemics. Socio-cultural research gaps (such as addressing gender, tackling prevention within the context of traditional cultures and taboos, transferring learning where appropriate from Africa, Brazil and elsewhere) and surveillance challenges need to be identified and addressed.

Biomedical prevention approaches such as the development of microbicides, increased use of antiretroviral treatments in prevention and the possibility of a low efficacy first generation HIV vaccine may emerge as important issues in the medium term. Australia has expertise in clinical, social and behavioural research that can support the implementation of these new prevention technologies. Researchers should be encouraged to integrate or link biological and behavioural research so the implications of new developments are better understood.

3.2.7 BLOOD SAFETY AND INFECTION CONTROL

There is a continuing need to prevent HIV transmission through blood products and Australia could play a greater role in providing technical assistance and capacity building to ensure that blood safety screening processes and blood bank services are implemented. Through the National Serology Reference Laboratory, Australia has developed expertise in quality assurance systems for screening procedures for HIV and other blood borne viruses. Australia already plays a role in quality assurance for laboratories and in improving occupational health and infection control standards in health care workplaces and should build on this expertise.

3.3 TREATMENT AND CARE

3.3.1 TOWARDS UNIVERSAL TREATMENT ACCESS 2010–2015

The past five years has seen significant advances in effective ART delivery in resource poor settings. There is increasing demand for sophisticated treatment regimes in resource and capacity poor settings. Several donors may be supporting parallel efforts to scale up treatment and care, often through vertical programs that stand outside government health systems. This can result in diverse approaches to treatment delivery that may not be sustainable.

AusAID should work through partnerships to facilitate access to HIV/AIDS treatment by all people

who need them in the Asia Pacific countries that receive Australian aid. Improved access to existing drugs for ART and prophylaxis and treatment of opportunistic infections, as well as access to new drugs and diagnostic and therapeutic technologies, is vital in dealing with the complex and changing nature of HIV/AIDS. More effective use of fixed dose ARV drug combinations and developing and implementing simplified and standardised approaches to treatment, including patient monitoring, is an immediate priority which needs to be supported by standardised training in ART delivery for health care workers.

In addition to ART, treatment and care needs that are poorly met in the region include prevention and management of tuberculosis, addressing reproductive needs, home and community based care, palliative care and funeral support, psycho-social support and management of paediatric HIV infection.

Treatment and care scale up strategies should be led by communities. Community preparedness measures such as treatment education are a necessary prerequisite to successful scale up. The experiences of people living with HIV/AIDS can help to improve the quality and acceptability of treatment and care by giving insight into how the uptake of services and adherence to drug regimens can be supported at the local community levels. Clinical centres need to explore options for fostering community involvement such as peer support groups, participation of community members on advisory boards or centre management, and involvement of people living with HIV/AIDS in counseling, support and treatment education. Community members working in partnership with health care workers should help to plan and implement treatment and care scale up strategies.

Australia needs to work at the country and sub-regional level in Asia, PNG and the Pacific to support nationally led treatment, care and support responses that:

- > involve people living with HIV/AIDS and affected communities in decision making
- > coordinate public sector, NGO, faith based, and private sector service provision

- > address gender equity and equitable access for marginalised populations such as drug users, sex workers and men who have sex with men
- > help strengthen the systems that deliver health services
- > strengthen procurement and supply management systems for drugs and diagnostics
- > provide treatment education and peer support services particularly addressing adherence issues, for people living with HIV/AIDS
- > address stigma and discrimination in the health sector by educating care and support workers and addressing occupational health and safety concerns
- > link HIV clinical services to treatment, care and support services addressing other needs commonly confronted by people living with HIV such as mental health services, STI services and reproductive health services
- > encourage governments to build treatment costs into their national budgets
- > promote alignment at the country level and harmonisation at the international level.

A first step is to work with governments and other stakeholders to support informed policy choices about treatment through assessing opportunity costs, cost effectiveness and the long-term financial implications of investments. Governments need to factor some HIV treatment costs into their own health budgets and not rely entirely on donor resources and GFATM grants.

Public-private partnerships should be encouraged where they have the potential to expand access to treatment and care and improve service coordination.

Treatment delivery in poor countries that have only rudimentary primary care services such as PNG will only be achieved through an intensive and long-term program of capacity building and health sector workforce development. In the short term, models of treatment delivery can be implemented that are simple and incorporate a basic care package including standardised ART, and prophylaxis and treatment for the most common opportunistic infections. These models can then be built upon as capacity improves in the medium- to long-term.

Capacity building is challenging and requires significant investment in training, adapting and reviewing treatment protocols, and upgrading laboratory capacities. Building ART delivery capacity will in many cases be an important entry point for developing primary care capacities for treating and preventing other prevalent diseases such as hepatitis, TB and malaria, and for improved maternal and child health care services. New models that integrate HIV and TB services should be developed, and the service delivery implications of the relationship between HIV, TB and reproductive health services needs to be better understood. There is likely to be pressure to justify the allocation of funds to HIV/AIDS at the apparent expense of TB and malaria, which in many countries in the region may represent greater current causes of morbidity and mortality than HIV/AIDS.

Injecting drug users in Asia have very high rates of co-infection with hepatitis C and/or hepatitis B, which complicates treatment options and can lead to higher rates of illness and deaths. The prospects of affordable treatment for hepatitis C remain remote. Investment in improving clinical management approaches for co-infected patients will be important in the Asian context.

3.3.2 TREATMENT SCALE UP IN PNG AND THE PACIFIC

GFATM funding to PNG and the Pacific provides opportunities to begin widespread testing and treatment programs, however this will only be feasible with parallel efforts to strengthen health systems including at the primary care level.

Since the Pacific has a relatively small but highly dispersed population of people living with HIV/AIDS, universal access to ART and prophylaxis and treatment for opportunistic infections in the sub-region is achievable in the short- to medium-term. Consistent with G8 commitments to support efforts to reach universal access to HIV/AIDS treatments by 2010 in Africa, Australia should work with other donors—particularly the Asian Development Bank (ADB), New Zealand and France—to achieve a target of universal HIV/AIDS treatment access by 2010 for all Pacific Island states.

One option to consider is establishing a Pacific Trust Fund that supplements the GFATM to support drug procurement, delivery systems, surveillance and Voluntary Counselling and Testing (VCT). Australia could explore this option if supported by other key donors and the SPC. In so far as this may mean that Australia contributes to financing ARV procurement directly rather than through GFATM contributions, this would be a diversion from the position established by Australia's existing *International HIV/AIDS Strategy*, which is that ARV procurement is best financed through global mechanisms and government negotiations with pharmaceutical companies. One possibility would be to fund the establishment of a regional procurement mechanism using GFATM funds to purchase ARVs.

For PNG, ART roll out is challenging particularly in rural and remote areas. ART delivery is only feasible in the medium term provided there is sustained and significant investment in building the capacity of health delivery systems and the health care workforce. Not only is there a lack of clinical facilities and lack of trained medical personnel, but immense difficulties are presented by geographic isolation, poor transport links, lack of basic storage facilities for drugs, and poor management of the supply chain for medical goods with a risk of essential drugs being diverted. Investment in ensuring secure supplies of essential medicines for HIV/AIDS and Opportunistic Infections (OIs) and diagnostics is a priority.

Advancing ART roll out in PNG will require Australia to provide substantial ongoing support to ensure that GFATM investments are well managed, that health system capacities are built, that essential medicines are regularly supplied, and that health sector workforce gaps are filled. Models for primary care provision, in which integrated services offer HIV testing, reproductive health services (including STI testing and treatment), ART, and TB testing and treatment, are required.

Australia may need to consider placing medical personnel in the field in PNG for lengthy periods before local systems reach sustainable levels of operation. To support this, Australia should consider establishing long-term partnerships between state and territory clinical centres in Australia and PNG hospitals and clinics. The role of the Church in

supporting treatment and care sustainability needs to be factored into a treatment scale up strategy for PNG.

3.3.3 TREATMENT AND CARE OF CHILDREN

Paediatric care needs are a neglected area that will require greater investment. Responses to children's treatment and care needs should include:

- > Measures to promote greater availability of low cost tests that allow early diagnosis in infants, child-friendly ARV drugs, and training of health care workers in paediatric care
- > Ensuring that women and couples who know they have HIV have access to advice and interventions to reduce the risk of transmission of HIV to babies
- > Integrated interventions to protect women from infection during pregnancy and the post-partum period when they are more susceptible to infection, and have a higher risk that HIV will pass to the baby
- > Careful planning of voluntary antenatal testing and PMTCT programs that include treatment, care and support interventions for those who test positive and their families
- > Population based strategies that take into account that most women do not know their HIV status, including promoting the nutrition and health of pregnant women, and supporting all women in developing countries to exclusively breastfeed for six months.

3.3.4 HUMAN CAPACITY DEVELOPMENT FOR TREATMENT AND CARE SCALE UP

Focus is required on strengthening the capacity of health systems, especially to ensure there are enough trained health workers to deliver treatment and care in urban and rural areas. Health workers in the region are concentrated in key urban areas that constrain efforts to increase national ART coverage. Workforce training requires the development of simplified and easily deliverable training on HIV medicine and care issues. HIV care does not have to be doctor driven in every setting. In poor rural areas,

for example, nurses can be trained as clinical officers so they can test and monitor ART.

Labour mobility and the impact of the brain drain from the region to Australia, New Zealand and other OECD countries needs to be included when assessing the capacity of the medical workforce to tackle expanding epidemics. Australia's recruitment practices in the health care sector should not exacerbate developing countries' human resource constraints.

Investment in training is required to support simplified testing strategies and the implementation of simplified treatment protocols. Strengthening the relationships between medical and scientific societies in the region can support capacity building, and Australian professional organisations (such as ASHM and medical colleges) are well placed to play a role in professional education and disseminating best practice. Train-the-trainer programs are required for nurses, pharmacists and doctors. Training is also needed at a managerial level for laboratory and clinic managers who may have little previous experience in how to employ, keep, mentor, and manage staff. Other training needs include data management, networking of services and training of engineers to maintain medical equipment.

Australia should continue to support regional approaches to investing in capacity building in public health and HIV/AIDS in the Pacific. This requires selecting focal points for investment and building on the work of the Pacific Regional HIV/AIDS Project and the SPC. Centres of expertise need to be developed in such fields as disease surveillance, testing and laboratory technologies, HIV medicine and clinical service standards, and culturally appropriate treatment education approaches.

In Indonesia and PNG, workforce capacity building needs to be tailored to national contexts. In PNG capacity building will need to be conducted largely by Australia and with the expectation that the Australian Government and professional and NGO agencies will play a significant role.

In some Asia Pacific countries, Australia may not be active in the health sector but may be able to influence other donors and multilateral agencies to

place a greater priority on health sector workforce development that supports treatment scale up.

In addition to technical skills, investment is required in building managerial skills in the region. The high turnover of managers of national and provincial AIDS control programs impedes scaling up prevention and care programs. Many countries do not have an adequate number of public health managers to implement large-scale programs. Creating capacities in institutions of excellence for training of public health professionals will support sustainability of program implementation.

3.3.5 TESTING AND MONITORING

Improving treatment access is linked to expanding HIV testing and clinical monitoring services, and opportunities for secondary prevention with people newly diagnosed. Different testing and monitoring models are needed according to local capacity and constraints on accessing laboratory services operating at the appropriate standard. Investment in laboratory upgrading is important for effective prevention and treatment. Laboratory delays can significantly impede the prevention of mother-to-child transmission through ARV prophylaxis. Investment is required in transfer of appropriate technology to allow effective and affordable laboratory services.

Australia should continue to support confidential Voluntary Counselling and Testing (VCT) as the preferred approach for testing in the region (as is the standard in Australia). VCT will generate community confidence in HIV services and attract populations most at risk into testing, as compared to models of mandatory testing without full consent. If routine testing models are introduced—such as the ‘opt out’ approach for testing all pregnant women—great care is needed to ensure that such models are not used as a back door mechanism to enable mandatory testing. Principles of confidentiality and fully informed consent should not be compromised, and protections from the adverse social consequences of an HIV diagnosis such as discrimination should be in place. Australia should also support expanded access to rapid testing technologies and improvement of laboratory capacities to enable more accurate and speedy HIV diagnostic services. The availability of

point-of-care, rapid HIV testing, and low cost and low technology CD4 tests is important to support treatment roll out.

3.3.6 ACCESS TO AFFORDABLE TREATMENTS AND TRADE POLICY

Australia needs to maintain a policy agenda that supports expanded access to affordable HIV medicines in developing countries (for example, in its position on WTO trade rules such as the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and in trade and investment agreements that affect access to medicines in poor countries). Australia should support ongoing efforts through multilateral systems to reduce HIV drug costs, particularly for new ARVs. This will increase in significance as new HIV drugs enter the market that are not available from generic suppliers. Competition from generic medicines has helped reduce the price of existing ARTs. New HIV drugs are essential for effective ‘second-line’ combination treatments that are required where more affordable first-line combinations fail due to emergence of drug resistant strains of HIV.

3.4 GENDER AND FEMINISATION

Responding to the feminisation of the HIV epidemic in Asia Pacific is a key medium-term challenge for the aid program. This involves considering the social roles played by men and women that influence HIV risk behaviour, the role of women as carers, and the factors that contribute to the vulnerability of women and girls to poor sexual and reproductive health outcomes.

Approaches to HIV prevention based on the ABC model (‘Abstain, be faithful, use condoms’) are likely to be limited in protecting women from HIV/AIDS unless broader contextual issues are also addressed. Prevention programs need to focus on individual risk taking and on the social and cultural factors that determine vulnerability to HIV/AIDS, such as the power men have over women and girls due to economic factors and traditional social roles. Prevention programs must recognise that the capacity of women and girls to negotiate safe sex is

constrained by power relationships—their economic wellbeing and personal safety may be threatened if sex is refused or an attempt made to insist on using condoms. Addressing gender comprehensively requires investing in interventions that target men and boys and address aspects of masculinity that determine social roles and behaviours, as well as programs targeting women and girls.

Increasing women's access to condoms, education, health care, support, safety, and justice all contribute to reducing HIV vulnerability. However, to achieve a lasting turnaround for women, a gender-sensitive approach to HIV/AIDS requires a better understanding of how male social roles, patterns of male mobility, and concepts of masculinity in different cultures contribute to HIV transmission and gender-based violence. This understanding then needs to inform the engagement of men and boys in HIV prevention.

AusAID should assess how development interventions can challenge and change social norms to promote gender equality. Changing attitudes and behaviours towards women and girls needs to begin during school education. It also needs to be addressed more broadly in the community through incorporating gender issues in leadership initiatives and by supporting advocacy by women on sexual and reproductive rights, including by women living with HIV/AIDS.

Promoting gender equality through reforms to laws and social policies can provide an environment that supports improvement in sexual health for women and girls. Reforms to property laws, inheritance laws and changes to traditional norms governing the status of women enable women to contribute to economic life outside the domestic sphere. Promoting economic independence places women in a stronger position to negotiate safety in sexual and interpersonal relationships and thereby reduces vulnerability to gender based violence, sexually transmitted infections and HIV/AIDS.

Australia should support research into the links between gender-based violence, HIV vulnerability and sexual and reproductive health outcomes. Australia should also play a greater role in promoting female controlled methods of HIV and STI

prevention for resource-poor settings (for example, female condoms, other barrier protection methods, and microbicides). Programs are required to respond to the needs of women and girls living with HIV/AIDS, including equity in access to treatment and care services and consideration of protection from discrimination, social ostracism, homelessness, and violence as a result of known HIV/AIDS status.

Service delivery models that support greater equity for women in access to HIV/AIDS prevention, care and support services are needed. Integrating HIV services with sexual and reproductive health services should aim to achieve higher levels of uptake of prevention and testing services by women and girls.

Investing in girls' education helps address key factors contributing to the feminisation of HIV—early marriage, economic dependency and limited knowledge of HIV/AIDS. Educated girls tend to marry later and are less likely to be economically dependent.

A gender-sensitive approach to HIV prevention and care is also critically important for addressing the needs of transgender populations. HIV vulnerability of transgender populations is exacerbated by discrimination, social ostracism and violence, as well as lack of prevention messages and HIV services tailored to their needs. Social constructs of masculinity often exacerbate the vulnerability of transgender populations to a range of health and personal safety threats including sexual violence. HIV and sexual health services need to explicitly consider the needs of transgender populations. Social research and behavioural surveillance should address issues confronting transgender populations.

3.5 WHOLE-OF-GOVERNMENT COHERENCE

Improved coherence of the Australian approach to HIV/AIDS in the region can be achieved through a whole-of-government framework that coordinates efforts of relevant government agencies (Section 2.7). Diplomatic posts should be encouraged to engage with counterparts in raising HIV/AIDS as a high-level political issue, not just a health issue.

As the government's agency of development aid expertise, AusAID remains central in providing

policy co-ordination, expertise in building capacity and monitoring and evaluating the impact and durability of HIV/AIDS interventions. AusAID should adopt a more proactive and pivotal role in coordinating and leading a whole-of-government policy response to HIV/AIDS globally and through program delivery in the region.

3.6 NEW WAYS OF WORKING

3.6.1 RAPID RESPONSE CAPABILITIES

AusAID's HIV/AIDS assistance has traditionally been delivered through time-limited projects managed by Australian Management Contractors. Projects have been tied to outputs and outcomes, which in some cases has constrained projects, preventing them from responding to changing circumstances. It also means projects have tended to take a short-term view or have been at odds with long-term, local program directions. Since responsibility for project implementation has rested with the Australian Management Contractors, it has sometimes been difficult to generate ongoing local ownership in a project and achieve sustainable outcomes.

In AusAID there has been a shift away from traditional project delivery mechanisms to program responses such as Sector-Wide Approaches (SWAPs) in the health and education sectors. This is desirable for achieving long-term developmental goals. However, in the context of rapidly expanding HIV epidemics Australia needs to develop the capacity to implement more interventionist responses for areas with acute needs. Vertical, stand-alone interventions can weaken national systems and responses. Therefore emergency responses need to be accompanied by efforts that focus on strengthening health systems and build a strong supportive environment.

A twin-track approach of responding to immediate needs and building capacity for long-term responses is required. If local governments lack the will or capacity to respond to HIV in an effective and

timely manner then, at least in the short-term, aid interventions may need to work through NGOs or establish new service delivery models parallel to public sector health services.

The aid program needs to have a more diverse menu of effective and responsive aid delivery options at its disposal. Direct project-style interventions and long-term, programmatic approaches each have benefits and problems. For HIV/AIDS, it is increasingly evident that Australia needs the capacity to intervene with rapid responses directed at critical focal points of emerging epidemics.

Radical approaches are required when existing systems are failing or are clearly inadequate. In settings such as PNG, emergency action against HIV/AIDS is called for, but the nature of this emergency is long-term. It is necessary therefore to consider how to institutionalise an emergency response. This may require placing technical experts in line agencies in recipient countries for substantial periods of time to ensure that effective delivery occurs without delay, as well as to build longer-term local capacity. Such interventions are costly in the short term but may prove highly cost effective in the long term if the result is to forestall a major epidemic.

3.6.2 HARMONISATION AND COLLABORATIVE APPROACHES

Fragmentation of HIV responses due to increasingly diverse sources of aid for HIV/AIDS is a major issue for many countries. To reverse this trend, Australia will need to:

- > actively explore opportunities for strategic collaboration with other donors
- > build on the Three Ones commitments and translate them into action, within the framework proposed by the *Report of the Global Task Team on Improving AIDS Coordination*²³
- > channel more support through multilateral partners in line with commitments to harmonisation

23 Global Task Team Report on Improving AIDS Coordination Among Multilateral Institutions and International Donors, UNAIDS, 2005.

- > work more closely with multilateral institutions, in particular GFATM, ADB, SPC, and UNAIDS and its co-sponsors the World Bank, UNDP, UNFPA, UNODC, UNICEF, ILO, UNHCR, UNESCO, WFP and WHO
- > strengthen the ability of multilateral organisations to support effective national action by increasing harmonisation and donor coordination, and providing high-level technical assistance.

Through its harmonisation work, AusAID should argue for increased international emphasis on HIV/AIDS in Asia Pacific, especially in Melanesia. Support for developing quality operational plans for implementing national HIV/AIDS strategies is an important prerequisite for harmonisation since it provides the common reference point for harmonisation efforts. Working more collaboratively will also involve:

- > private-sector partnerships
- > technical support through research partnerships and workforce development programs
- > pooling of resources with other donors where this will support harmonisation and more effective programming.

Consideration should be given to harmonising donor efforts through pooled funding mechanisms that channel bilateral and multilateral support on HIV/AIDS, thereby reducing the aid transaction burden on recipient governments. It will be difficult to harmonise aid programs and priorities fully when donor funding is conditional, given that such conditions may relate to other donors' domestic political considerations rather than to evidence of what works.

Australia should continue to support the GFATM and advocate for improvement of its operations so its systems promote national ownership and are characterised by simplified, rapid and transparent processes. Developing the absorptive capacity of public and community sectors is the greatest current challenge in ensuring that new funds provided by the GFATM flow through to programs in Asia Pacific. GFATM is not proving effective in some Asia Pacific countries because of the lack of country capacity to manage and spend new funds effectively and under complex GFATM requirements. Australia can help

to address this through supporting countries to prepare applications and comply with monitoring and reporting requirements. Through representation on GFATM's governing Board Australia can support the adoption of a more calibrated approach that responds to different country needs and encourages cost-effective use of funds.

Australia should also explore the potential benefits of developing responsive and flexible funding mechanisms for specific HIV-related needs that might be more appropriately addressed through donor coordination outside the GFATM process.

3.6.3 POLICY ENGAGEMENT

Well targeted policy interventions can achieve significant change as a result of relatively small investments. Lessons learnt from frontline delivery need to be systematically fed back into policy interventions. Priority should be accorded to supporting policy development at the national level, and this should encompass HIV issues across diverse portfolios such as justice, welfare, transport, migration, and health. Policy support at the regional level can be provided through assisting regional bodies such as ASEAN and the SPC. Particularly in Indonesia and other large Asian countries, provincial governments should be offered technical assistance in HIV/AIDS strategy development and related policy issues. Australia is well placed to play a leading policy role in the HIV aspects of illicit drugs policy, bridging health, corrections, and justice policy issues.

3.6.4 RESEARCH AND PRACTICE PARTNERSHIPS

An expanded and continuously improved evidence base is essential to the success of the Australian aid program's HIV/AIDS response. Delivery requires investment in long-term partnerships with research institutes, development practitioners and HIV/AIDS agencies in the region. The Australian Government should promote stronger links between national HIV/AIDS responses and domestic HIV/AIDS expertise.

Greater focus should be given to long-term research and practice partnerships. Generating an evidence

base for planning, policies and programs requires stronger links between Australian research institutions and regional and international centres. The aim should be to develop centres of regional research excellence in HIV/AIDS and development that directly informs policy and practice. To ensure long-term sustainability in responding to HIV/AIDS and other health threats, a research strategy should build research capacities in PNG, the Pacific and South-East Asia, in the clinical, epidemiological, behavioural, and socio-cultural research fields.

Priorities for research include:

- > epidemiological and behavioural surveillance
- > the cultural, economic and political dynamics that are driving the epidemic
- > the nexus between HIV/AIDS, poverty, economic activity, and development
- > Asian and Pacific experiences of feminisation and gender impacts.

In the prevention sphere a key emerging issue is the impact of biomedical prevention methods on behavioural prevention approaches. In the treatment sphere areas of research that support ART scale up include operational research on ART protocols suitable for resource poor settings, the impact of integrating prevention and treatment services, constraints on ART and VCT uptake, viral resistance, and adherence and treatment education needs and services. Population-based ARV resistance studies can provide evidence of the success of training of health care workers in ART delivery, adherence by people taking ART, and the effectiveness of monitoring.

Research into quality of life issues affecting people living with HIV/AIDS is essential to ensure that there is an understanding of the complexity and diversity of psychosocial needs, including such issues as wellbeing, mental health, experiences of discrimination and social connectedness.

Models of research that actively engage communities in developing and participating in research should be supported. Communities in which research occurs should be supported in participating not just as research subjects but as partners who can inform the definition of research questions and the design, management and practice of research.

Greater attention need to be given to the ethics of HIV research in resource poor settings and the necessity of community participation in research decision-making. This is particularly important given the history of criticism of the ethics of HIV clinical trials in developing countries and concerns regarding consent issues that arise in HIV surveillance.

In addition to maintaining its role in the social and behavioural sciences relating to HIV, drug use and sexual health, Australia is likely to continue to play an important global role in basic science and clinical research relating to HIV/AIDS. The Australian Government can fund this research through National Health and Medical Research Council grants, ARC grants and the work of the National HIV Research Centres.

It may be important for Australia's medium-term response for the Government to consider how new support or incentives (for example, through the tax system) can be provided to Australian researchers in developing new prevention technologies for use in developing countries, particularly microbicides. A female-controlled method of STI and HIV prevention could be highly beneficial in the PNG and Pacific contexts where women's low social status is a critical factor in vulnerability. Australian biotechnology companies are already involved in microbicide research. The potential for Australia to contribute to public-private partnerships to support clinical testing of products in developing countries in our region, with the support of agencies such as the International Partnership for Microbicides, should be investigated.

3.6.5 REGIONAL CAPACITY DEVELOPMENT STRATEGY

AusAID should develop an Asia Pacific HIV/AIDS Capacity Development Strategy to enable Australia to build on its skills and expertise to strengthen technical and workforce capacity issues in the region. The goal of the strategy would be to assist communities, health systems and governments to rapidly develop the capacity to build a workforce to implement HIV responses in priority areas. The strategy would make expertise in Australia available in a strategic and systematic way, and should aim to build capacities through five-to-ten-year frameworks. The Government should invest in a business

development model to mobilise Australian technical and training expertise for workforce development. This may require developing a mechanism for seed funding of programs in specific areas.

Australia should focus on areas in which it has a comparative advantage, including:

- > clinical, epidemiological, social, behavioural, and economic research capacities
- > HIV medicine, laboratory technical skills and transfer of medical technologies
- > STI control including testing, treatment and education strategies
- > infection control
- > harm reduction for injecting drug users
- > HIV prevention and sexual health promotion needs of sex workers and men who have sex with men
- > working with people living with HIV/AIDS groups on advocacy, care, support, and prevention
- > law and justice sector responses to HIV/AIDS that provide an enabling environment for health promotion
- > developing leadership and policy development skills for bureaucrats and the community sector.

A program should be developed that allows for:

- > the design and development of program modules for key activities and/or priority populations (Table 3)
- > liaison with partner training providers in Asian and Pacific countries
- > liaison and marketing with the major international donors active in the region
- > contract development advice, including on advice on export incentives.

Alternative models for implementing the strategy need to be considered such as the creation of an Asia Pacific Centre on HIV/AIDS, a network of centres, or a consortium of agencies in Australia and across the region working to an agreed program. The program would aim to maximise a collegiate and collaborative approach to employing the skills and strengths of Australia's HIV/AIDS expertise in enhancing capacity in the region.

AusAID may fund some implementation in-country, but in most cases the cost of implementing

these training programs and modules would be met by international donors—for example, the ADB, USAID, the Ford Foundation, and the UK Department for International Development (DfID)—and regional governments.

Australia is relatively inexperienced in responding to needs that arise in major generalised epidemics, such as orphan care and support. Some Australian NGOs have experience in these areas as a result of work in Africa and an assessment should be made of how best to transfer lessons learned to Asia and PNG.

3.6.6 DEVELOPMENT PARTNERS AND COOPERATIVE TECHNICAL ASSISTANCE

In its approach to development assistance, AusAID should value contestability of ideas including acknowledging the entitlement of countries to consider a menu of options for HIV interventions. Partner countries will expect that they will be afforded an opportunity to consider the relative merits of different approaches to key challenges such as stigma, leadership, and addressing the needs of vulnerable populations. AusAID's approach to technical assistance can support partner countries in managing their responses through providing evidence of effectiveness of interventions and by facilitating access to technical assistance from a range of sources. This will support countries to actively shape their HIV responses.

AusAID should explore opportunities for cooperating with other countries in the region to provide technical assistance to developing countries. For example, opportunities may exist for cooperating with China and Hong Kong in providing technical assistance to third countries on issues such as responding to HIV transmission through injecting drug use or working with media agencies to address stigma and raise awareness. There may also be opportunities for delivering HIV/AIDS programs in the region in partnership with Japan, Thailand and India. Opportunities for providing technical assistance through multilateral mechanisms should also be investigated. For example, the UNAIDS Technical Support Facility for South-East Asia and the Pacific will be established in 2006.

4 Key recommendations

HIV/AIDS INTEGRATED AS A CORE DEVELOPMENT ISSUE

1. HIV/AIDS needs to be woven into AusAID country strategies regardless of the presence or not of a specific HIV/AIDS project. This needs to be a core element of each country strategy as an individually crafted approach.

SOCIAL AND POLITICAL MOBILISATION TO SUPPORT SCALED UP RESPONSES

2. AusAID should support more focused action to influence the socio-political contexts in which the HIV/AIDS epidemic emerges by moving beyond stand-alone projects to a more comprehensive strategy that engages political, faith and business leaders and mobilises communities for comprehensive national action.

3. Australia's parliamentary group on HIV/AIDS and regional parliamentary groups should be supported in taking a more active leadership role.

4. All diplomatic staff should be briefed on HIV/AIDS so they have the knowledge to play a leadership role and advocate for improved HIV/AIDS responses.

5. An advisory mechanism comprising representatives of the HIV and development sectors, researchers, and people living with HIV/AIDS should be established to provide advice to AusAID

on policy and strategy relating to the epidemic, with a focus on leadership issues.

6. The Australian Government should remain committed to the Asia Pacific Leadership Forum on HIV/AIDS and encourage it to focus on progress at country level and mobilisation of civil society leadership. The Australian Government should develop a Business Sector Leadership Initiative on HIV in Asia Pacific, to encourage Australian businesses to adopt best practice workplace HIV/AIDS policies and to play a stronger leadership role on HIV/AIDS in countries where they operate.

7. The aid program should support people living with HIV/AIDS and community based groups to adopt national leadership roles, including through capacity building of regional and national organisations and networks.

GEOGRAPHIC FOCUS OF AUSTRALIA'S REGIONAL RESPONSE

8. AusAID should give priority to addressing the emerging epicentres of the epidemic in Indonesia, PNG and the Pacific. Top priority should be effort to elevate the breadth and depth of the response to HIV/AIDS in PNG. Australia should also make a significant contribution to fighting HIV/AIDS in East and South-East Asian countries. Where Australia has comparative advantage, it should work bilaterally (for example, in PNG and Indonesia). Where other donors and multilateral agencies have stronger comparative

advantage, Australia should work through these agencies (for example, South Asia and Africa).

9. The Australian Government should promote the unique needs of the region through multilateral processes such as monitoring the UNGASS Declaration of Commitment on HIV/AIDS, and participating on the Boards of UNAIDS and GFATM.

FLEXIBILITY AND RESPONSIVENESS TO URGENT NEEDS

10. In PNG and other countries where an emergency HIV response is warranted Australia should develop capacity to rapidly deliver focused interventions where it will make a difference in stemming escalating epidemics and relieving personal and community impacts of HIV/AIDS, in parallel with longer term capacity building efforts. AusAID should invest in ensuring that GFATM funds in PNG are well managed.

TREATMENT SCALE UP

11. Australia should work with other donors to secure universal treatment access in the Pacific by 2010 and in PNG as soon as practicable. Consideration should be given to establishing a Pacific Trust Fund for HIV/AIDS that supplements GFATM by resourcing improved regional procurement mechanisms. The Australian Government should work through multilateral processes to ensure that essential HIV medicines are affordable to developing countries.

GENDER AND FEMINISATION

12. Country strategies should consider the need to address feminisation of the epidemic as an emerging trend. Systems should be introduced to promote gender equity in access to HIV services. Interventions should address male and female social roles affecting vulnerability. Health, education and justice sector policies should challenge and change social norms to promote gender equality.

RESEARCH AND PRACTICE PARTNERSHIPS

13. Australia should support the development of long-term research and practice partnerships in the region to build capacity and expertise in responding to the HIV/AIDS needs of PNG, the Pacific and South-East Asia. Centres of research excellence in HIV/AIDS and development should be established that generate an evidence base for planning, policy development and program delivery.

HARMONISATION AND ALIGNMENT

14. Australia should implement the recommendations of the *Global Task Team Report on Improving AIDS Coordination among Multilateral Institutions and International Donors* and work increasingly through partnerships with other donors' bilateral programs and regional and global multilateral institutions. In particular, Australia should work more closely with UNAIDS, its UN system co-sponsors, GFATM, SPC, and the Asian Development Bank in coordinating and targeting regional responses.

WHOLE-OF-GOVERNMENT RESPONSE

15. Improved coherence of the Australian approach to HIV/AIDS in the region can be achieved through a whole-of-government framework that coordinates efforts of relevant government agencies. AusAID should adopt a pivotal role in coordinating a government-wide policy and program response to HIV/AIDS.

CAPACITY DEVELOPMENT STRATEGY

16. AusAID should develop an Asia Pacific HIV/AIDS Capacity Development Strategy that more effectively uses Australian expertise in addressing workforce and broader capacity issues. A key feature will be the potential to attract funds from other donors to support in-country implementation. Australia should invest in capacity building in such fields as community based prevention, surveillance, testing and laboratory technologies, HIV medicine and clinical service standards, treatment education approaches, and building community and public sector managerial and leadership skills.

Table 3: Asia Pacific HIV/AIDS Capacity Development Strategy. Resource Matrix: Australian skills and expertise

This Matrix is not exhaustive. It does, however, exemplify the analysis required to establish a regional HIV/AIDS capacity development program.

Priorities/ target populations	Program planning and project design	Project management and reporting	HIV prevention curriculum	Peer outreach work	Treatments education
Injectors	Yes	Yes	Yes	Yes	No
Sex workers	Yes	Yes	Yes	Yes	No
Gay-MSM	Yes	Yes	Yes	Yes	Yes
People living with HIV/AIDS	Yes	Yes	Yes	Yes	Yes
Leaders and potential advocates	Yes	-	-	-	-
Policy analysts and legal skills	Yes	-	Yes	Yes	Yes
Clinical services delivery personnel	Yes	Yes	-	-	Yes
Clinical researchers	Yes	Yes	-	-	-
Social, behavioural and epidemiological researchers	Yes	Yes	-	-	-
Community organisation leaders / managers	Yes	Yes	-	-	-

Glossary

ADB	Asian Development Bank
AFAO	Australian Federation of AIDS Organisations
AFP	Australian Federal Police
AHAPI	AusAID Australian HIV/AIDS Partnership Initiative
APEC	Australian Pacific-Economic Cooperation
APLF	Asia Pacific Leadership Forum on HIV/AIDS and Development
APN+	Asia Pacific Network of People Living with HIV/AIDS
ART	Antiretroviral therapy
ARVs	Antiretroviral drugs
ASEAN	Association of Southeast Asian Nations
ASHM	Australasian Society for HIV Medicine
CCMs	Country Coordinating Mechanisms
CD4	T cells, CD4 tests provide an indication of immune system status
DFAT	Department of Foreign Affairs and Trade
DfID	UK Department for International Development
GFATM	Global Fund to Fight AIDS, Tuberculosis and Malaria
GIPA	Greater Involvement of People Living with HIV/AIDS
ICAAP	International Congress on AIDS in Asia Pacific
ILO	International Labour Organisation
MDG	Millennium Development Goals
NAPWA	National Association of People Living with HIV/AIDS
NHRMC	National Health and Medical Research Council
OI	Opportunistic Infections
PEP	Post exposure prophylaxis
PEPFAR	President's Emergency Plan for AIDS relief
PMTCT	Prevention of mother to child transmission
PNG	Papua New Guinea
RAMSI	Regional Assistance Mission to Solomon Islands
SPC	Secretariat of the Pacific Community
STI	Sexually Transmitted Infections

SWAPs	‘Sector wide approaches’ to development assistance eg through donor pooling for government led health sector programs
UNAIDS	Joint United Nations Programme on HIV/AIDS
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Population Fund
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations Children’s Fund
UNODC	United Nations Office on Drugs and Crime
USAID	US Agency for International Development
VCT	Voluntary Counselling and Testing
WFP	World Food Programme
WHO	World Health Organization

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