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AusAID

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

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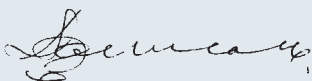
Dear Minister

On behalf of Meryl Williams, Stephen Howes and myself, I would like to present to you our report on recommendations for a White Paper on Australia's aid program.

We would like to thank all those who generously devoted their time and ideas to the report through the public consultations and seminars as well as comments provided through the AusAID web-site. Most of all we would like to thank those AusAID officers, both in Canberra and overseas, as well as officers from other Australian Government agencies, that contributed significantly to the report. An observation shared by the entire team is the very professional and collegiate way in which the various arms of Government are engaged in overseas development.

Finally, we would like to thank you for providing the group with this exciting opportunity and I look forward to the White Paper's release early next year.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ron Duncan', with a stylized flourish at the end.

Ron Duncan

Chair

White Paper Core Group

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Abbreviations and Acronyms

| | |
|----------|---|
| AAC | Aid Advisory Council |
| ACIAR | Australian Centre for International Agricultural Research |
| ADB | Asian Development Bank |
| ADF | Asian Development Fund |
| AFP | Australian Federal Police |
| AGD | Attorney General's Department |
| ADAB | Australian Development Assistance Bureau (AusAID's former name) |
| AIDS | Acquired Immune Deficiency Syndrome |
| AIPRD | Australia-Indonesia Partnership for Reconstruction and Development |
| ANAO | Australian National Audit Office |
| ANU | Australian National University |
| APEC | Asia-Pacific Economic Cooperation |
| ARDS | Australian Regional Development Scholarships |
| ASEAN | Association of Southeast Asian Nations |
| ATSE | Australian Academy of Technological Sciences and Engineering |
| AusAID | Australian Agency for International Development |
| BIMSTEC | South Asian Association for Regional Cooperation and the Bay-of-Bengal |
| CDI | Centre for Democratic Institutions |
| CPIA | Country Policy and Institutional Assessment (of the World Bank) |
| DAC | Development Assistance Committee (of the OECD) |
| DFAT | Department of Foreign Affairs and Trade |
| DFID | Department for International Development (United Kingdom) |
| DIFF | Development Import Finance Facility |
| DIME | Development Impact Monitoring and Evaluation Initiative (of the World Bank) |
| EC | European Commission |
| ECP | Enhanced Cooperation Program |
| EU | European Union |
| FAO | Food and Agriculture Organisation (United Nations) |
| GDP | Gross Domestic Product |
| GNI | Gross National Income |
| GOI | Government of Indonesia |
| HECS | Higher Education Contribution Scheme |
| HIPC | Heavily Indebted Poor Countries |
| HIV/AIDS | Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome |
| IDA | International Development Association (of the World Bank) |
| IDS | International Development Statistics (collated by the DAC) |
| IFC | International Finance Corporation (of the World Bank) |

| | |
|--------|---|
| IFI | International Financial Institution |
| LAPIS | Learning Assistance Program for Islamic Schools (Indonesia) |
| LDC | Least Developed Country |
| MDG | Millennium Development Goal |
| NGO | Non-Government Organisation |
| ODA | Official Development Assistance |
| ODE | Office of Development Effectiveness (AusAID) |
| OECD | Organisation for Economic Cooperation and Development |
| ORE | Office of Review and Evaluation (AusAID) |
| OCISP | Ombudsman Commission Institutional Strengthening Project (in PNG) |
| PIC | Pacific Island Country |
| PMR | Policy and Management Reform Fund (Pacific) |
| PNG | Papua New Guinea |
| PNGIF | Papua New Guinea Incentive Fund |
| PPIAF | Public-Private Infrastructure Advisory Facility |
| RAMSI | Regional Assistance Mission to Solomon Islands |
| SARS | Severe Acute Respiratory Syndrome |
| Sida | Swedish Agency for International Development Cooperation |
| SNI | Sub-National Initiative (Papua New Guinea) |
| SPC | Secretariat of the Pacific Community |
| STI | Sexually Transmitted Infection |
| TA | Technical Assistance |
| TB | Tuberculosis |
| UK | United Kingdom of Great Britain and Northern Ireland |
| UN | United Nations |
| UNAIDS | Joint United Nations Programme on HIV/AIDS |
| UNDP | United Nations Development Programme |
| UNFPA | United Nations Population Fund |
| UNICEF | United Nations Children's Fund |
| US/USA | United States of America |
| USAID | US Agency for International Development |
| WDR | World Development Report (World Bank) |
| WHO | World Health Organization |
| WTO | World Trade Organization |

i Executive Summary

A White Paper outlining a medium-term strategic framework for Australia's aid program will be tabled in Parliament in early 2006. This report provides analysis and recommendations for the White Paper for consideration by the Government. It has been prepared by a Core Group of three members, headed by Professor Ron Duncan of the University of the South Pacific and including Dr Meryl Williams and Dr Stephen Howes.

The importance of the White Paper was underlined by the Prime Minister in his announcement at the United Nations Heads of State Summit in September 2005. The Prime Minister stated Australia's goal to double its aid budget to \$4 billion by 2010, subject to 'the effectiveness of the application of additional resources' and 'conditional on strengthened governance and reduced corruption in recipient countries.' He concluded by noting that:

A White Paper on aid is currently being prepared and decisions about further aid allocations will need to take close account of the White Paper's conclusions about the effectiveness of Australia's aid programme and needs and priorities for the period ahead.

CONTEXT

Australia's aid program has already undergone significant changes in terms of volume and delivery over the last few years. These include major and unprecedented programs of assistance to Solomon Islands, Papua New Guinea and Indonesia. But this

is only a taste of the changes which the aid program will experience over the next few years. To reach \$4 billion, aid will need to increase by an average of \$300 million a year over the next five years. This rapid scaling up will need to be managed effectively in order to turn the tremendous opportunity it represents into effective development outcomes.

Australia has a strong and relevant aid program that operates in diverse contexts. Australia is an important donor in microstates such as Tuvalu as well as in Indonesia, a country in the early stages of democracy and with the world's fourth largest population. The issue for this report, however, is not how well the aid program currently operates. The large announced increase in the aid budget will in itself usher in many changes. The central challenge that we address in this report is how to ensure that these changes take the aid program in the right direction, towards not only greater volumes but also higher impact. In particular, we provide recommendations to ensure that the announced aid increase is used productively, improves rather than undermines effectiveness and strengthens the means by which assessments of aid performance can be made.

The environment in which the aid program will be operating in the coming years will also be one of immense contrast and change and of unforeseen events both natural and man-made. The Asia-Pacific region has seen unprecedented levels of economic growth and poverty reduction over the last twenty

years – with over 500 million people lifted out of poverty in this period – but major economic, political and social challenges remain. Importantly though, not all countries in the region are performing well. Parts of Asia are doing much better than others, while most Pacific island countries are hardly growing at all.

New threats to stability and development have emerged. The Asia–Pacific region is particularly prone to natural disasters and pandemics; it is predicted to become the next HIV/AIDS epicentre; emerging infectious diseases such as bird flu could cause catastrophic damage; and transboundary threats such as terrorism, environmental degradation and people trafficking threaten investment, growth and poverty reduction.

The increases in aid budgets worldwide reflect the growing realisation of the importance of reducing poverty and promoting sustainable development, not only as a humanitarian obligation but also as a matter of national interest for developed countries. This is true from both security and economic points of view. Given our location in the Asia–Pacific region, this is nowhere more the case than for Australia. The ability of our neighbours to manage their borders effectively, respond to outbreaks of infectious disease and maintain stability is central to our own peace and prosperity. Critical to the ability of Australia’s aid partners to perform well is the sound functioning of their key institutions of state and their ability to provide opportunities for their populations, particularly the poor, to participate in the economy and raise their standard of living.

Primary responsibility for the delivery of Australia’s aid program rests with the Australian Agency for International Development (AusAID). A significant proportion of Australia’s Official Development Assistance (ODA) is now also delivered by government agencies other than AusAID (other government department expenditure is estimated at close to 25 per cent of Australia’s \$2.5 billion in ODA in 2005–06). These include a range of entities, from the Australian Centre for International Agricultural Research (ACIAR), with a budget of \$54 million and

an exclusive focus on international development, to much larger ones such as the Treasury and the Australian Federal Police, which now, in addition to their domestic responsibilities, also provide development assistance. While the coverage of our report is on the aid program (i.e. all ODA), the predominant focus is on the work and directions of AusAID as the primary agency for implementing Australia’s aid program.

The recommendations of this report are based on the analysis contained in the six background analytical reports¹ commissioned to assist the Core Group, on the public consultations and discussions with Government and other donors that were undertaken, as well as on our own reading of the wider development and aid experience. Our own analysis, which is contained in the second and third chapters of the report, is not summarised here. It is worth stating at the outset though that aid is only one small part of the development equation. Much more important are developing country policies and institutions. Other developed country policies also matter, including trade and immigration policies. Although their relative importance will vary from country to country, these other policies will often matter more than aid. In particular, there is little point in donors increasing aid if their trade policies restrict market access for exports from developing countries. But, if used well, aid can help countries strengthen their institutions and exploit the opportunities afforded by greater openness to trade and investment.

STRATEGIC FRAMEWORK

The starting point for this report is the overarching objective of the aid program: ‘to advance Australia’s national interest by assisting developing countries reduce poverty and achieve sustainable development’. Reducing poverty in our region clearly has benefits for Australia. This needs to be well communicated, as does the progress of Australia’s major development partners towards the Millennium Development Goals.

1 Analytical reports were prepared on Indonesia, Asia, Pacific Island Countries, Papua New Guinea, HIV/AIDS in the Asia Pacific Region, and Engaging the Australian Community. A full listing of these reports is provided at the start of the reference list. The reports themselves are included in the companion volume to this report. From here on they will be referred to as the ‘analytical reports’.

To achieve this objective we recommend the aid program should organise itself around four interlinked themes: accelerating economic growth, fostering functioning and effective states, investing in people, and promoting regional stability and cooperation.

Growth is listed as the first of the four priorities to stress that, without growth, sustained poverty reduction will not be possible. Fostering functioning states is critical since the evidence is pointing increasingly to appropriate and effective institutions as the bedrock of prosperity. Investing in people provides the opportunity for all citizens, especially the poor, to participate in the economic growth of their countries. Promoting regional stability and cooperation will become increasingly important in a world which is ever more integrated, and in which cooperation between nation states is required to tackle the rising level of transboundary threats and to seize the opportunities from economic integration.

It is important to stress that the aid program must remain selective if it is to maximise its impact. It cannot be all things to all countries, or even to one country. We see the country strategy as the critical means for determining the focus of Australia's support to particular countries under the four themes, taking into account individual country circumstances, priorities and other donors programs.

THEMATIC PRIORITIES

Under each of these major themes we recommend various approaches and initiatives for the aid program to adopt. These are briefly summarised below.

1. ECONOMIC GROWTH

Governance reforms are important for growth but we are of the view that the growth agenda cannot be reduced to improving institutional quality. Institutional reforms take a long time to deliver and many of Australia's neighbours need to generate growth much sooner – to provide employment for growing populations and to underpin stability. And growth itself can be a powerful force for improved governance reforms, leading to a virtuous circle. We

propose, therefore, a 'governance-plus' agenda for growth, with three focus areas:

- (i) improving the policy environment for growth, including by helping to address the difficult issue of land tenure in the Pacific through a demand-driven Pacific Land Mobilisation Program
- (ii) supporting the drivers of growth, including infrastructure, training, rural development and small to medium enterprise development. Among other recommendations, we suggest an Australian Asia Infrastructure Fund to help Asia address its most binding constraint to growth
- (iii) sustaining growth in the face of environmental challenges. We recommend the development of a new environment strategy for the aid program.

2. FUNCTIONING AND EFFECTIVE STATES

Australia's aid program has increased assistance for governance significantly (up to \$885 million budgeted in 2005-06). While the focus on governance is commendable, this assistance can be delivered more effectively by:

- (i) pursuing improved policy and institutional quality across the program. Improved institutions should be the aim of the entire program, not only of a sub-set of governance activities. For example, better governance might sometimes best be supported by promoting education
- (ii) focussing not only on economic policies and law and order, though these are important, but also on improving the quality of decision making at the political level. This can be done by using incentives for improved performance, strengthening the demand for reform and investing in future leaders
- (iii) making more selective and opportunistic use of technical assistance
- (iv) giving greater attention to conflict prevention, nation-building and emergency management.

3. INVESTING IN PEOPLE

Better human development outcomes and greater gender equity allow people to live better lives and are of instrumental value for achieving higher economic growth and social stability. We argue for a sharp increase in the aid program on investing in people. Such interventions should focus on:

- (i) strengthening national systems of health and primary and secondary education
- (ii) further expanding Australia's HIV/AIDS leadership role and response, including increasing the aid program's emergency response to HIV/AIDS in Papua New Guinea (PNG)
- (iii) preventing and, if necessary, managing pandemics
- (iv) launching an initiative to roll back and ultimately eradicate malaria in the Pacific
- (v) supporting higher education through scholarships and institutional links
- (vi) strengthening gender equality through stronger mainstreaming and new initiatives in the areas of women's and girls' health and education.

4. REGIONAL STABILITY AND COOPERATION

Many development solutions today require coordinated action across a group of countries. Three areas have emerged where support for regional approaches need to be expanded:

- (i) countering transboundary threats, including pandemics, natural disasters, people smuggling, drug trafficking, money laundering and terrorism
- (ii) supporting regional integration initiatives, including through the Association of Southeast Asian Nations (ASEAN), Asia-Pacific Economic Cooperation (APEC), the Greater Mekong Subregion Program and what emerges from the East Asia Summit
- (iii) promoting regional governance in the Pacific, including support for elements of the Pacific Plan.

EFFECTIVENESS

This report focuses as much on the 'how' of aid (i.e. how to promote effectiveness of aid delivery), as on the 'what' (i.e. the thematic priorities for the aid program). The aid program already does many things well. It has an international reputation for responsiveness, pragmatism and flexibility. We propose four strategies to enhance its effectiveness.

1. STRENGTHENING THE PERFORMANCE ORIENTATION OF THE AID PROGRAM

To enhance the capacity of the aid program to learn and improve, we make recommendations which would put Australia at the forefront of bilateral donors in terms of the rigour and strength of aid evaluation. In particular, we propose an Office of Development Effectiveness, primarily for AusAID but also as a resource for other Australian government departments providing development assistance. This office should produce an annual report on development effectiveness to coincide with budget deliberations. We also propose a greater focus on linking aid activities to results or outputs, the inclusion of a performance framework within country strategies for major partners to assess impacts at a broader country or sectoral level, and incentives to reward good performance within and between countries.

2. COMBATING CORRUPTION

Proposals to link the aid program more effectively with efforts to reduce corruption include mainstreaming anti-corruption considerations into aid activities, pursuing a more whole-of-government approach to tackling corruption, and supporting regional and global initiatives such as the Extractive Industries Transparency Initiative.

3. INTEGRATING AND BROADENING THE AUSTRALIAN ENGAGEMENT WITH THE ASIA-PACIFIC REGION

The development of Australia's whole-of-government approach, by which a range of agencies are engaged in providing international assistance in their

specialist fields of influence, is welcome. But it also demands greater efforts of coordination. At least with regard to major countries, we recommend that AusAID country strategies be upgraded into whole-of-government country development strategies to provide a single strategic and implementation framework for the delivery of Australian aid. These country strategies, once embedded in a performance framework, could also provide the basis for compacts with major partner countries and thus embed the idea of mutual obligation.

Australia has a good record on policy coherence. AusAID should continue to build on its role in government discussions on non-aid policies that impact on development such as trade and migration.

There will be high returns from the broader Australian community taking a greater interest in development in the region. The aid program, while not trying to be all things to all people, should seek to strengthen linkages across non-state actors and the private sector, and should support expanded research on development.

4. WORKING IN PARTNERSHIP WITH RECIPIENT COUNTRIES AND OTHER DONORS

AusAID should work more closely with partner government systems and with private and other non-state actors in partner countries. Over time, AusAID should shift from a heavy reliance on direct implementation of activities towards a more diversified approach in which it also supports development partners to implement activities. Pursuing greater harmonisation and coordination with other donors is critically important for reducing fragmentation and transaction costs for aid recipients. We recommend a more pro-active approach to engaging with the World Bank and Asian Development Bank (ADB), as well as other key multilateral institutions, in areas of critical interest, so as to leverage Australian initiatives and work more efficiently.

COUNTRY ISSUES

It is at the country level that thematic priorities and aid modalities need to be combined and selectivity exercised. The Asia–Pacific focus of the aid program is long-standing and has served Australia well. There was little support in our consultations for a change in this approach. Nevertheless, there are questions about how the aid budget should be allocated within the region and there are important country-specific issues in the diverse region within which Australia operates.

ASIA

Indonesia and the Philippines face threats to their competitiveness and growth. These countries need to generate growth to underpin stability and legitimacy. Australia's engagement in Indonesia has already been expanded, and we recommend a strengthened engagement with the Philippines in partnership with key players. In particular, we recommend that the lagging eastern Indonesia – southern Philippines region be adopted as a focal point for the aid program in Asia. Another should be the fast growing, integrating, but still vulnerable Mekong region. For maximum impact, assistance programs to the region should be done in collaboration with the multilateral development banks.

While China and India are both rapidly growing countries, we argue that their sheer strategic importance and size means that significant aid programs should be maintained and based on engagement and sharing of experiences. The programs could include targeted scholarships in areas of shared critical interest, as well as institutional linkages. Other South Asian countries are deserving of increased aid because of their higher levels of poverty, but more extensive engagement in these countries must be weighed against the need to maintain selectivity.

There is significant scope to expand assistance to Asia, particularly to South-east Asia and its lagging regions and through engagement strategies with India and China.

THE PACIFIC AND PNG

We are deeply concerned about the future of the Pacific, in particular the Melanesian countries and the microstates. While a few Pacific countries are doing reasonably well, the analytical report on the Pacific concludes that, in the absence of much better domestic government performance, the likely future for the region is a 'deterioration of services and increasing levels of poverty'. The analytical report on PNG gives no greater grounds for optimism. Indeed, the HIV/AIDS crisis emerging in PNG only adds to the sense of gloom.

The future of the Pacific, including PNG, lies in integration. Many of the small states can thrive if they are integrated with the global economy. Integration will require greater openness of the Pacific island economies to trade, investment and competition. It will also require better functioning governments, higher levels of human development and more extensive infrastructure.

Although by no means a panacea, part of the integration solution is migration. Migration and remittances have served the Tongan and Samoan economies well. We recommend an expansion of migration opportunities especially for the Melanesian countries. We support the Australian Government's recent announcement to help establish a regional technical training facility to provide greater opportunities for skilled migration. Consideration should also be given to increasing opportunities for unskilled migration, and further analysis of migration and development links should be undertaken. For the microstates of the Pacific, migration is perhaps the only route to viability.

Since PNG's independence Australian aid has declined significantly, but substantial assistance is still required for governance and to support a renewed emphasis on the drivers for growth and investing in people. Per capita aid levels to PNG are now well below those in other Pacific countries. There is a case for substantially increased assistance for PNG, subject to good performance. The Pacific countries receive some of the highest aid per capita in the world. Aid allocations are adequate in general, but additional funding may be needed for specific high-priority initiatives.

AFRICA AND THE MIDDLE EAST

While there is a strong humanitarian case for providing aid to Africa, we recommend that Australian support to Africa be provided largely indirectly, through multilateral channels or other bilateral donors. It should be ensured, however, that lessons and success stories are shared between Africa with Asia and the Pacific. The aid program will also need to retain capacity to respond to conflict situations in the Middle East and Afghanistan, and to contribute to international initiatives.

CONCLUSION: THE CHALLENGE OF SCALING UP

Globally, aid levels are expected to increase from around US\$50 billion in the 1990s to US\$130 billion in 2010. This is an enormous change. The biggest challenge facing aid agencies worldwide, including Australia, will be to manage effectively this unprecedented increase. We recommend that Australia's aid program retain and build on current strengths, including by preserving the flexibility which being an all-grant program provides, and by completely untying the aid program to enhance value for money. It should avoid becoming over-ambitious, and practise selectivity. Finally, scaling up the aid program will need to be accompanied by deepening skills and by adequate resourcing for the delivery of aid.

We are not proposing sharp departures from current areas of focus, but rather have recommended changes of approach and emphasis. Nevertheless, taken together the recommendations will result in a much changed aid program – not only much larger because of the Prime Minister's announcement on aid, but also more effective. Simply scaling up current practices is not likely to be effective, nor is it really an option. While it is important that Australia's aid program retain its strengths of flexibility and responsiveness, it is also imperative that the opportunity be grasped to reshape and reorient the aid effort. Expectations will need to be managed. Even when scaled up, aid will remain a relatively minor determinant of development success. It is legitimate, however, to expect a better performing program, able to make a difference and show results. Australian aid, if used to innovate and demonstrate new ways of achieving development, can have not only a regional but also a global impact.

ii Summary of Recommendations for Australia's Aid Program

STRATEGIC FRAMEWORK

- 4.1 Adopt the themes of accelerating economic growth, functioning and effective states, investing in people, and promoting regional stability and cooperation as the **strategic framework** for the Australian aid program, and prepare regional and country strategies and other interventions within this framework.
- 4.2 Assist in regional and/or national efforts to report progress against the **Millennium Development Goals**.

THEMATIC PROGRAMS AND INITIATIVES

ACCELERATING GROWTH

- 5.1 Assist partner governments to improve the **policy environment for growth** by:
- (a) reforming regulatory policies and facilitating trade
 - (b) helping key partner countries develop growth strategies
 - (c) developing a Pacific Land Mobilisation Program to survey and support improvements in land tenure systems, in collaboration with regional agencies and interested governments.
- 5.2 Expand support for **infrastructure** through the provision of ideas and funding, in collaboration with other aid agencies, in particular the development banks, including through:

(a) exploring the feasibility of an Australian Asia Infrastructure Fund to be operated in partnership with the World Bank and/or the Asian Development Bank

(b) participation in the Public-Private Infrastructure Advisory Facility

(c) giving priority to adequate funding for maintenance.

- 5.3 Use the aid program to provide **skills training** to build more competitive workforces in the Pacific Islands, both for domestic labour markets and to promote labour mobility.

- 5.4 Increase the emphasis of the aid program on **rural development** and on support for **small and medium enterprises**. Consider the feasibility of a small and medium enterprise development program for the Asia-Pacific region.

- 5.5 Develop an environment strategy to guide an expanded but strategic engagement on issues around **sustainable development**.

FOSTERING FUNCTIONING AND EFFECTIVE STATES

- 5.6 **Helping states function more effectively** should be an overall focus of the aid program and of country strategies, rather than the mandate of a sub-set of governance activities.

- 5.7 In weaker-performing countries, focus the aid program on **political governance** as well as the rule of law and economic and bureaucratic governance. This will require:
- (a) a more integrated cross-government approach
 - (b) recognising the long timeframes involved, more emphasis on strengthening future leaders
 - (c) making greater use of incentives in the aid program
 - (d) providing more support to non-state actors.
- 5.8 Make more selective and effective use of **technical assistance (TA)**. This will require:
- (a) being more explicit about objectives
 - (b) using TA predominantly where there is clear demand for it and an opportunity to make progress in critical reform areas
 - (c) in non-reform environments, calibrating resources, expectations and objectives towards building relationships and maintaining a dialogue with key partner government agencies
 - (d) increasing the accountability of TA providers to their counterpart governments
 - (e) shifting the focus of TA away from planning, and towards implementation and monitoring.
- 5.9 Improve **emergency responses, conflict prevention and nation building efforts** by:
- (a) ensuring that Australia can, wherever possible, anticipate and respond quickly to emergencies in the Asia-Pacific region, both natural disasters and state/societal breakdowns, by strengthening standby capacities and whole-of-government cooperation
 - (b) developing strategies which draw on private as well as public, and state as well as central government, expertise and resources in such responses
 - (c) strengthening whole-of-government partnerships in post-conflict situations to help, where possible, identify and reduce vulnerability to future instability.
- ## INVESTING IN PEOPLE
- 5.10 Devote increased aid resources to delivering sustained improvements in access to and quality of **health and school education systems** in partner countries. This will include:
- (a) focusing health interventions on women and children and on health problems that cause the greatest burden of disease
 - (b) focusing education interventions on ensuring quality universal primary education that has good literacy and numeracy outcomes, and on secondary education and vocational training.
- 5.11 Scale up our response to the **major diseases** in our region, with the particular objectives of:
- (a) further strengthening Australia's HIV/AIDS response, including the aid program's emergency response to the HIV/AIDS epidemic in PNG and taking the lead in pursuing an international commitment to provide universal HIV treatment in the Pacific and PNG as soon as practical
 - (b) rolling back malaria in the Pacific
 - (c) trying to prevent and, if necessary, manage influenza pandemics.
- 5.12 Expand **scholarships**, especially to Asia, with a particular focus on:
- (a) ensuring they target studies of high priority and potential leaders from the private, non-government and public sectors
 - (b) supporting locally provided courses offered by Australian institutions, to promote greater cost-effectiveness and institutional strengthening
 - (c) supporting alumni associations to maintain links with former Australian students.

- 5.13 Promote **gender equality** by:
- (a) emphasising women's and girls' education and health, including reproductive health and family planning
 - (b) strengthening gender mainstreaming.

PROMOTING REGIONAL STABILITY AND COOPERATION

- 5.14 The aid program should promote regional understanding of, and responses to, **transboundary threats** to stability and development.
- 5.15 In Asia, the aid program should support an expanded range of **regional cooperation initiatives**, based on a careful assessment of their contribution to effective regional integration.
- 5.16 In the Pacific Islands, the aid program should:
- a) continue and expand support for **regional governance** solutions
 - b) develop a framework for deciding when to assist in the Pacific on a regional or country-specific basis.

MAXIMISING EFFECTIVENESS

STRENGTHENING THE PERFORMANCE ORIENTATION OF THE PROGRAM

- 6.1 **Build performance into individual activities** through better monitoring and increasing use of output-based or results-based approaches to aid, where practical.
- 6.2 **Strengthen the link between performance and allocations** between and within countries to encourage and reward good performance, and undertake further research on how incentives and performance can best be built into aid programs.

- 6.3 Strengthen the evaluation function through the establishment of an **Office of Development Effectiveness** which would:

- (a) take responsibility for both quality monitoring and evaluation
- (b) publish an Annual Review of Development Effectiveness
- (c) report directly to the AusAID Director General, have its own budget and be a resource for all Australian government agencies delivering ODA
- (d) evaluate country strategies as well as individual interventions.

- 6.4 Develop a policy that would increase **public disclosure** levels relating to the aid program.
- 6.5 Work with **partner countries** to help them better monitor their performance; and collaborate in international efforts to improve evaluation.
- 6.6 Upgrade the focus on **country strategies** as the key planning and review document for Australian development efforts to major partner countries. They should:
- (a) include all ODA-eligible activity
 - (b) ensure selectivity
 - (c) provide a more rigorous performance framework
 - (d) operationalise performance agreements with partners.

COMBATING CORRUPTION

- 6.7 **Mainstream anti-corruption** in the aid program, including through a new anti-corruption strategy.
- 6.8 Adopt a **whole-of-government approach** to the reduction of corruption in Australia's development partner countries.
- 6.9 Support **regional and global initiatives** to combat corruption, including the Extractive Industries Transparency Initiative.

INTEGRATING AND BROADENING AUSTRALIA'S ENGAGEMENT WITH THE ASIA–PACIFIC REGION

- 6.10 AusAID should build on and develop its **engagement on whole-of-government development issues**, in collaboration with the concerned departments and agencies.
- 6.11 Promote **political engagement on development issues relating to political governance**, including pursuing the formation of an Australian parliamentary group on the Pacific.
- 6.12 Ensure that aid interventions by different government departments are consistent with a **single development framework**, ideally a whole-of-government country strategy (see Recommendation 6.6). Maintain contestability in decisions regarding aid delivery.
- 6.13 Promote **development research** by:
- (a) expanding the overall development research budget
 - (b) strengthening the Australian Centre for International Agricultural Research's links with the broader aid program's rural development program and with the private sector and relevant non-government organisations
 - (c) redirecting AusAID's research fund towards a mix of strategic partnerships and competitive grants, and encourage research partnerships with developing countries
 - (d) diversifying the development research budget with more research funding for areas such as political governance, growth, health and education.
- 6.14 Explore ways to expand aid **linkage programs** in ways that maximise impact, maintain accountability standards and minimise administrative burden. Look for greater opportunities for developing country non-state organisations to participate in the aid program.

WORKING WITH PARTNERS

- 6.15 AusAID should work more closely with **partner governments** by:
- (a) accelerating its move towards programmatic approaches
 - (b) shifting away from a heavy reliance on direct implementation of activities towards a more diversified approach in which it also supports partners (governments or non-state actors, as appropriate) to implement development activities.
- 6.16 AusAID, together with partner governments, should consider increasing the use of the **private and non-government sectors** as implementing agents for delivery of the aid program in the key sectors of infrastructure, rural development, health and education. This is particularly important in fragile states.
- 6.17 Improve **harmonisation** between donors:
- (a) AusAID should monitor its performance against the harmonisation indicators of the Paris Declaration
 - (b) greater use should be made of delegation arrangements, especially on a project-by-project basis, and of sectoral leadership roles
 - (c) stronger relationships should be established with the 'new donors' particularly in the Pacific.
- 6.18 The Australian aid program should engage more effectively with **multilateral agencies** by:
- (a) significantly expanding its support to the World Bank and the Asian Development Bank, both to core concessional funding and through a range of strategic partnerships
 - (b) pushing for reform of the International Financial Institutions to give the developing world, particularly in Asia, greater voice
 - (c) engaging more strategically with other relevant international organisations.

SELECTED COUNTRY ISSUES

- 7.1 For **Indonesia**:
- (a) maintain high levels of assistance and continue to extend support for infrastructure, basic education, rural development, and small and medium enterprise growth
 - (b) make a timely decision on arrangements to follow the current Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) commitment in order to aid planning and program development work.
- 7.2 Expand the Australian aid program in the **Philippines**.
- 7.3 Focus on **lagging and vulnerable regions** in Asia:
- (a) adopt the southern Philippines – eastern Indonesia region, and the fast growing but vulnerable Mekong region, as focal points for the aid program
 - (b) develop substantial programs in these regions in collaboration with the multilateral development banks.
- 7.4 Develop strategic aid programs in **India** and **China** as vehicles for mutual exchange and cooperation.
- 7.5 Undertake further analysis and research on the relationship between **migration** and development, especially in the Pacific.
- 7.6 The allocation of **aid to PNG** should increase over time, subject to agreed performance benchmarks being met.
- 7.7 **Pacific aid allocations** are adequate in general, but additional funding may be needed for specific high-priority initiatives.

7.8 For other regions:

- (a) support development and humanitarian programs in Africa largely through multilateral organisations and other bilateral donors, and ensure lessons and success-stories are shared between Africa and the Asia-Pacific region
- (b) retain capacity within the aid program to respond to conflict situations in the Middle East and Afghanistan, and to contribute to related international initiatives.

MEETING THE CHALLENGE OF SCALING UP

- 8.1 Australia's aid program should be completely and immediately **untied**. All future tenders should be open to bidders of all nationalities.
- 8.2 Provide AusAID and other relevant agencies with sufficient **resources** to scale up increased development assistance efficiently and effectively.

1 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 in a year's time he would present a White Paper on Australia's Aid Program.

The announced objective of the White Paper is to outline a medium-term strategic blueprint for Australia's aid program that will ensure it continues to address regional development priorities in the most effective and efficient way possible.

A Core Group, headed by Professor Ron Duncan and including Dr Meryl Williams and Dr Stephen Howes, was commissioned to produce a report for the Government providing recommendations for the White Paper.^{2,3} The Core Group was given the task of considering lessons learnt from international and Australian experience, as well as the latest development thinking, to frame recommendations on the strategic direction of the aid program over the next ten years. The *Guide for the Core Group*, effectively the terms of reference for the report, is contained in the companion volume which provides supporting documentation for this report.

This report draws upon geographic and thematic analyses commissioned to inform the development

of the White Paper. These background 'analytical reports', included in the companion volume, are on Papua New Guinea (PNG), the Pacific, Indonesia, Asia, HIV/AIDS and engaging the Australian community.⁴ The analyses involved consultations with partner governments, other donors, academics, the private sector, community organisations and other relevant experts. For the Core Group report there was also regular and wide consultation across the Australian Government. A senior-level reference group met regularly during the process and involved representatives from the departments of Foreign Affairs and Trade, Prime Minister and Cabinet, and the Treasury. Public meetings involving the Parliamentary Secretary to the Minister for Foreign Affairs were conducted in Brisbane, Melbourne, Perth and Sydney. Targeted seminars on key topics such as transboundary issues, growth and political governance were also held. Numerous comments and submissions were received through the Australian Agency for International Development's (AusAID) White Paper web-site. Video conferences and roundtable discussions were held with key multilateral agencies including the World Bank, Asian Development Bank (ADB) and United Nations (UN) agencies. Extensive consultations were also held with AusAID staff and management. The

2 Professor Duncan is Executive Director, Pacific Institute of Advanced Studies in Development and Governance at the University of the South Pacific and Emeritus Professor at the Australian National University. He has broad experience in academia, academic publishing, government and with the World Bank. His expertise relates to the economics of East Asia and the Pacific. Dr Williams is the Chair of the Board of Management and President of the Policy Advisory Council of the Australian Centre for International Agricultural Research. She has an eminent record in fisheries and has held a number of senior positions in Australia and overseas, including as Director General of the WorldFish Centre for 10 years. Dr Howes is AusAID's Principal Economist and has responsibility for advising on all aspects of development economics and leading the economics advisory group. Prior to taking up this position he worked for the World Bank, managing the Bank's economic work in India. He has extensive experience in researching Asian economies, tax reform and poverty.

3 The Core Group was supported by a secretariat housed in AusAID. The secretariat is headed by Peter Versegi and included at various times: Andrew Edge, Karen Crockett, Gemma Jackson, Rachel Payne, Hannah Bleby and Melanie Calvert.

4 A full listing is provided at the start of the reference list.

methodology for developing this recommendations report and the subsequent White Paper is set out in Attachment I. The analytical reports, together with a summary of key points raised in public consultations and the Core Group's responses to them, are contained in the companion volume of this report.

Primary responsibility for the delivery of Australia's aid program rests with AusAID. A significant proportion of Australia's Official Development Assistance (ODA) is now also delivered by government agencies other than AusAID (other government department expenditure is estimated at close to 25 per cent of Australia's \$2.5 billion⁵ in ODA in 2005-06). These include a range of entities, from the Australian Centre for International Agricultural Research (ACIAR) with a budget of \$54 million and an exclusive focus on international development, to much larger ones such as the Treasury and the Australian Federal Police, which now, in addition to their domestic responsibilities, also provide development assistance. While the coverage of our report is on the aid program (i.e. all ODA), the predominant focus is on the work and directions of AusAID as the primary agency for Australia's aid program.

The aid program has been the subject of a series of reviews and policy statements over the past decade. The 1997 review of the aid program *One Clear Objective: Poverty Reduction through Sustainable Development* (the Simons Review) was followed by the Government's policy statement *Better Aid for a Better Future* released later that year. Subsequent major statements of Government aid policy are contained in Ministerial Statements to Parliament in 2002 *Investing in Growth, Stability and Prosperity* and in 2005 *Australian Aid: An Integrated Approach*. Significant management reforms have been guided by AusAID's 2001 Strategic Plan *Improving Effectiveness in a Changing Environment*. The major outcomes from these and earlier reviews and a summary of the evolution of the aid program are contained in the companion volume of this report.

The development of a new aid strategy graduated from being a good and timely idea to an urgent necessity with the Prime Minister's announcement at the United Nations Heads of State Summit on 13 September, 2005. The Prime Minister stated Australia's goal to increase its aid budget to about \$4 billion by 2010, subject to 'the effectiveness of the

application of additional resources' and 'conditional on strengthened governance and reduced corruption in recipient countries.' He concluded by noting that:

A White Paper on aid is currently being prepared and decisions about further aid allocations will need to take close account of the White Paper's conclusions about the effectiveness of Australia's aid programme and needs and priorities for the period ahead.

In effect, this announcement became the new terms of reference for the Core Group: What should a greatly expanded aid program look like? How do we ensure effectiveness? How do we link increased aid and reduced corruption?

The report is structured as follows:

- > **Chapter 2 – Strategic Context** outlines the evolving regional and global environment, the international response to global development issues, and Australia's interest in and contribution to a stable and prosperous Asia-Pacific region.
- > **Chapter 3 – International Development Thinking and Lessons** seeks to distil what has been learnt from international and Australian experience and capture recent thinking on development and aid.
- > **Chapter 4 – Strategic Framework for the Aid Program** puts forward a new four-pronged strategic framework for the aid program to respond to the changing context and lessons learnt.
- > **Chapter 5 – Thematic Programs and Initiatives** makes specific recommendations for each of the four proposed themes of the aid program.
- > **Chapter 6 – Maximising Aid Effectiveness** makes recommendations on how Australia's aid should be delivered and proposes initiatives designed to maximise its impact.
- > **Chapter 7 – Selected Country Issues** considers some of the major challenges facing the aid program in Australia's key partner countries and recommends directions for the future.
- > **Chapter 8 – Conclusion: Meeting the Challenge of Scaling Up** outlines the challenges the aid program will face as aid volumes increase.

5 Unless otherwise stipulated, Australian dollars (\$) or A\$ are used throughout the report.

2 Strategic Context

The environment in which the aid program will be operating over the next ten to fifteen years will be one of immense contrast and change, and, as we have seen in recent years, of unforeseen events both natural and man-made. This chapter summarises the global and regional record of development to date, outlines emerging issues for the Asia–Pacific region and summarises the international aid response. It concludes with a discussion of Australia’s interests in the region and the evolution of Australia’s aid program.

2.A THE RECENT GLOBAL AND REGIONAL DEVELOPMENT RECORD

Recent decades have delivered unprecedented improvements in the standard of living in poor countries. From 1950 to 2000 life expectancy in developing countries increased by more than 20 years, rising from the forties to the mid-sixties.⁶ Whereas in 1970 one in two adults in developing countries was illiterate, now it is one in four. 390 million people in developing countries were lifted out of poverty between 1981 and 2001,

corresponding to a decline in the percentage of those living in poverty from 40 per cent to 21 per cent.⁷

However, for all this progress, poverty remains one of the most serious problems facing the world today. In 2001 there were still 1.1 billion people living on less than one US dollar a day. As the President of the World Bank has recently reminded us, ‘Every week in the developing world, 200,000 children under five die of disease and 10,000 women die giving birth.’⁸

The Millennium Development Goals (MDGs) are a set of global development objectives to be achieved by 2015 (see Box 2.1). Recent analysis concludes that the world as a whole is on track to achieve the MDG target of halving global poverty.⁹ Good progress is also being made with respect to the MDG targets for water supply and for education (increasing overall enrolments and reducing gender disparities). But little progress is being made with respect to health outcomes and sanitation. For example, one MDG target calls for a three-quarter reduction of the maternal mortality ratio by 2015, but in developing countries this ratio has hardly changed in the past 15 years.¹⁰

6 For this and the next point, see Stern, Dethier and Halsey (2005).

7 Chen and Ravallion (2004)

8 The Associated Press 14/11/05

9 See DFID (2005a) and UN Millennium Project (2005). Bhalla (2002) has argued that the goal of halving global poverty has already been achieved. Even if he is correct, and the claim is disputed by most poverty measurement experts (Deaton, 2003; Ravallion, 2003), by Bhalla’s own estimates 13 per cent of the developing world was still poor in 2000, equating to over 400 million people.

10 DFID (2005a), p. 30

BOX 2.1 THE UN MILLENNIUM DEVELOPMENT GOALS

The Millennium Development Goals (MDGs) are a set of global development objectives to be achieved by 2015 that were unanimously adopted at the United Nations Millennium Summit in September 2000. Attainment of the eight individual goals is to be measured by progress against 18 associated targets.

1: Eradicate extreme poverty and hunger

Reduce by half the proportion of people living on less than a dollar a day.

Reduce by half the proportion of people who suffer from hunger.

2: Achieve universal primary education

Ensure that all boys and girls complete a full course of primary education.

3: Promote gender equality and empower women

Eliminate gender disparity in primary and secondary education preferably by 2005, and at all levels by 2015.

4: Reduce child mortality

Reduce by two thirds the mortality rate among children under five.

5: Improve maternal health

Reduce by three quarters the maternal mortality ratio.

6: Combat HIV/AIDS, malaria and other diseases

Halt and begin to reverse the spread of HIV/AIDS.

Halt and begin to reverse the incidence of malaria and other major diseases.

7: Ensure environmental sustainability

Integrate the principles of sustainable development into country policies and programs; reverse loss of environmental resources.

Reduce by half the proportion of people without sustainable access to safe drinking water.

Achieve significant improvement in lives of at least 100 million slum dwellers by 2020.

8: Develop a global partnership for development

Develop further an open trading and financial system that is rule-based; predictable and non-discriminatory; and includes a commitment to good governance, development and poverty reduction – nationally and internationally.

Address the least developed countries' special needs. This includes tariff- and quota-free access for their exports; enhanced debt relief for heavily indebted poor countries; cancellation of official bilateral debt; and more generous official development assistance for countries committed to poverty reduction.

Address the special needs of landlocked and small island developing states.

Deal comprehensively with developing countries' debt problems through national and international measures to make debt sustainable in the long term.

In cooperation with the developing countries, develop decent and productive work for youth.

In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries.

In cooperation with the private sector, make available the benefits of new technologies – especially information and communications technologies.

Progress has been uneven across regions, with Asia making much better progress towards the MDG targets than Africa. East Asia has been by far the most successful region in reducing poverty, with over 500 million people in the region lifted above an income of one US dollar a day over the last twenty years. This corresponds to a decline in the proportion of those living in poverty from 58 per cent in 1981 to 15 per cent in 2001. Poverty in South Asia has also fallen steadily from 52 per cent to 31 per cent over the same period. In sub-Saharan Africa, however, the number of those living in poverty almost doubled in the last twenty years to 312 million and the proportion of poor people has increased from 42 per cent to over 46 per cent.¹¹

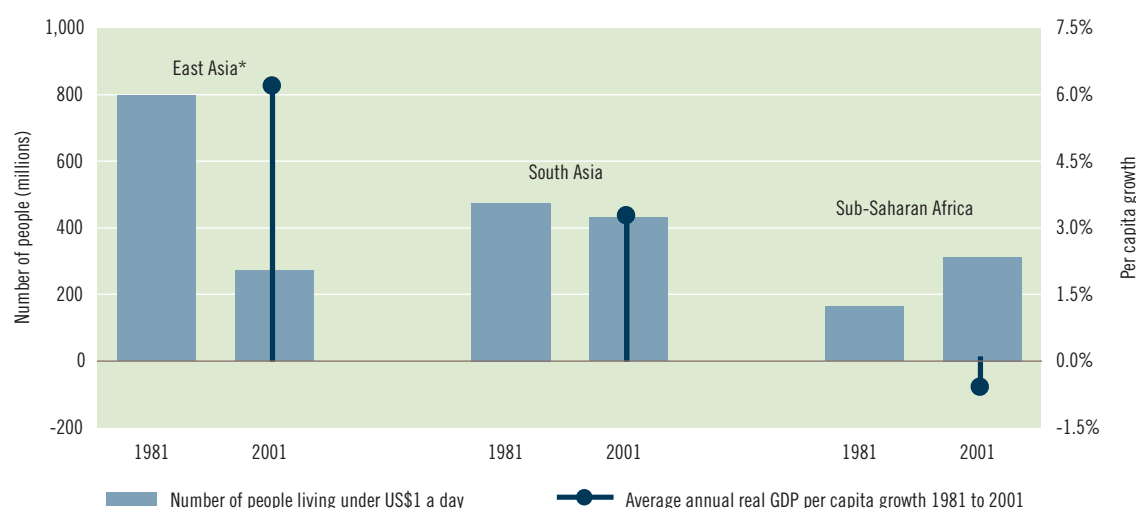
Differences in poverty reduction in Asia and Africa have been driven by remarkably divergent growth performances, as figure 2.1 shows. East Asia, which has had the most rapid poverty reduction, has experienced the most rapid growth over the last 20 years – an annual per capita average of 6.2 per cent. South Asia has had just over half the economic growth and more moderate poverty reduction. And sub-Saharan Africa has had negative

per capita economic growth and experienced a substantial increase in poverty.

Growth in Asia has been driven by trade and global integration. East Asian exports grew from 2 per cent of global exports in 1960 to 18 per cent in 2004. South Asia is a much smaller trader by global standards, but the share of trade to gross domestic product (GDP) in South Asia has grown from 15 per cent in the mid-seventies to above 30 per cent today.¹²

In spite of its remarkable progress, Asia is still a poor part of the world. In Asia some 700 million people live on less than one US dollar a day and 1.9 billion people on less than two US dollars a day, close to four times as many as in sub-Saharan Africa. In Indonesia for example, while poverty levels have been declining (the percentage of people living on less than one US dollar a day fell to 7.2 per cent in 2003), more than half of the population still live on less than two US dollars a day. This leaves them vulnerable to a range of shocks, from financial crises and slowdowns in global growth, to instability and natural disasters.

FIGURE 2.1 POVERTY AND GROWTH IN ASIA AND AFRICA



Source: Chen and Ravallion (2004) and World Bank Development Statistics Online.

* The average GDP per capita growth figure shown for East Asia is the average for East Asia and the Pacific. Growth figures are based on GDP at constant 2000 US\$.

11 Chen and Ravallion (2004)

12 Dasgupta, Howes and Shingal (2005)

Growth has also been unequally distributed across Asia, which is still home to seven Least Developed Countries (LDCs).¹³ While Cambodia and Laos have both shown progress from a low base, they are particularly vulnerable. Burma and North Korea remain disengaged from the world economy and the Philippines has experienced slow growth over a long period. Figure 2.2 shows the variation in growth across the Asia–Pacific region.

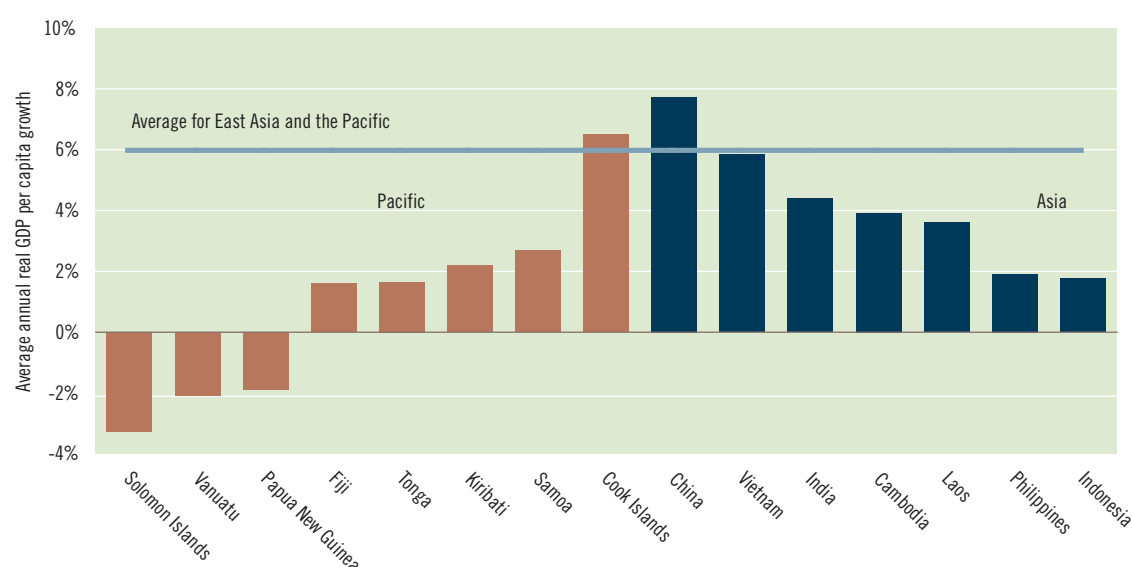
Asia's overall economic success stands in sharp contrast to the economic difficulties faced by the Pacific Islands. Some countries have done better than others – Cook Islands has grown at a rate per capita of 6.5 per cent between 1995 and 2004, and Samoa has grown at 2.7 per cent over the same period. But others have done much worse – annual per capita growth in the Melanesian economies has mainly been negative over the past decade. Partly this is due to instability, particularly in Solomon Islands where civil unrest contributed to a 25 per cent decline in GDP from 2000 to 2003. While the Pacific Islands have seen impressive gains in social

indicators in the past, recent rates of improvement have slowed. And new health threats are on the rise, including non-communicable 'life style' diseases such as diabetes – worst affected is Nauru where an astounding 45 per cent of the population suffers from type-II diabetes. The Pacific Islands attract little global attention on account of their small population, but are important to Australia because of their geographical proximity, shared history and, frankly, the threat they pose to regional stability. With its low growth, fragile states, health risks and high vulnerability, the Pacific shares many of the features of the region that now commands the major part of global development attention – Africa. Indeed, in terms of progress towards the MDGs, only sub-Saharan Africa is doing worse than the Pacific.¹⁴

2.B DEVELOPMENT PROSPECTS AND EMERGING ISSUES FOR THE ASIA–PACIFIC REGION

In this section, we sketch out likely future trends for the Asia–Pacific region and consider a number

FIGURE 2.2 GROWTH IN ASIA AND THE PACIFIC – 1995 TO 2004



Source: World Development Indicators Online; Cook Islands figure from the Pacific analytical report. Figures based on GDP at constant 2000 US\$.

- 13 Least Developed Countries are defined by the United Nations using three criteria: income per capita of less than US\$ 750 per annum, weaknesses in human resource profile, and economic vulnerability. With those criteria, Asia is home to the following Least Developed Countries: Bangladesh, Bhutan, Cambodia, East Timor, Laos, Burma and Nepal. The number rises to eight if Afghanistan is included in the definition of Asia.
- 14 The UN Millennium Project (2005) report considers performance against 20 MDG targets. For nine of the targets Oceania shows 'no or negative change'. Only sub-Saharan Africa shows a higher figure (13).

of important emerging issues relating to stability and security; transboundary threats and crises; demographic change, migration and urbanisation; and integration.¹⁵

A REGION OF STRONG AND WEAK STATES

Analysts agree that, in aggregate, growth in Asia will continue as China and India continue to benefit from economic reforms and as they profit from – and themselves drive – increased trade. Over the longer term, it is expected that the world's economic centre of gravity will continue to shift to Asia. Some argue that by 2050 China and India will join the United States and Japan as the four largest economies in the world.¹⁶

The continuing growth of China and India represents opportunities and challenges for countries in the region. Those that are able to integrate effectively will be competitive and see their fortunes rise. But some economies may not be able to adjust quickly and deeply enough in response. Several countries in the Asia-Pacific region, including Cambodia, Laos, PNG and much of the Pacific, may lack the policies and institutions, as well as the human capacity and physical and social infrastructure, to capitalise on regional growth. This may also be the case for East Timor notwithstanding potential revenue gains from oil and gas over the medium term. Indonesia and the Philippines (home to over 90 per cent of the population of South-east Asia) face deteriorating competitiveness and physical infrastructure. The competition for foreign investment is becoming intense, from both within the region and from countries such as Poland that have the added attraction of access to the lucrative European Union market.

Arguably, it is these weaker and, in some cases, 'fragile' states that represent the greatest development challenge in our region and the greatest threat to shared growth. They have either struggled to adopt productive approaches to growth and development, or are vulnerable to slow-down or

derailment. Whether this is because of inhibiting initial conditions, instability and conflict, or because of poor political leadership, weak governance and corruption, it is clear that innovative and persistent means of engagement are required to help redress their fortunes. We return to the issue of state fragility in Chapter 3 and subsequently throughout the report.

STABILITY AND SECURITY

Social stability is one of the most important preconditions for sustained growth and poverty reduction. Research has estimated that the poorest 20 per cent of the world's population suffer from 80 per cent of its civil wars.¹⁷ Experiences close to home in Bougainville and Solomon Islands have shown the devastating impact conflict can have on hard-won development gains. The links between security and development were articulated in the United Nations Secretary-General's High-Level Panel report released last year (see Box 2.2).

At the macro level, regional stability over the next ten years will depend in part upon how the great power relationships evolve between the US, Japan, China, India and Russia, and how the region accommodates the economic and political rise of China and India. Apart from traditional hot spots such as the Korean Peninsula, Kashmir and the Taiwan Sea, there are also continuing intra-state tensions such as those in the southern Philippines and parts of Indonesia. In both these countries broad-based growth will be critical to shore up support for democracy and to promote stability.¹⁸

Wherever it exists, the spectre of terrorism will deter investment and employment generation. For instance, the impact of the Bali bombings is likely to have a lasting impact on its economy, affecting disproportionately the poor who depend on tourism for their livelihood. While poverty is not a primary cause of terrorism, bleak economic prospects provide a fertile recruiting ground and, coupled with weak governance, havens for terrorist networks to flourish.

15 Further discussion can be found in the Asia analytical report.

16 Goldman Sachs (2003)

17 World Bank (2003)

18 See Indonesia analytical report.

BOX 2.2 SECURITY, CONFLICT AND DEVELOPMENT

Security and development are inextricably linked.

The 2004 report from the United Nations Secretary-General's High-Level Panel on Threats, Challenges and Change argues that development is critical both for traditional conceptions of security focused on the state and military solutions, as well as for the broader concept of human security. The broader definition of human security goes beyond the protection of individuals from violent conflict and encompasses protection from threats such as economic insecurity, hunger, disease and transboundary crime.

Development as the first line of defence. The report identifies six clusters of threats to security: economic and social threats such as poverty, infectious disease and environmental degradation; inter-state conflict; internal conflict; nuclear, radiological, chemical and biological weapons; terrorism; and transnational organised crime. In order to achieve security, promoting equitable economic development and building state institutions and capacity are crucial, particularly in the law and justice and public health sectors. Development can help combat existing challenges as well as help build state capacity.

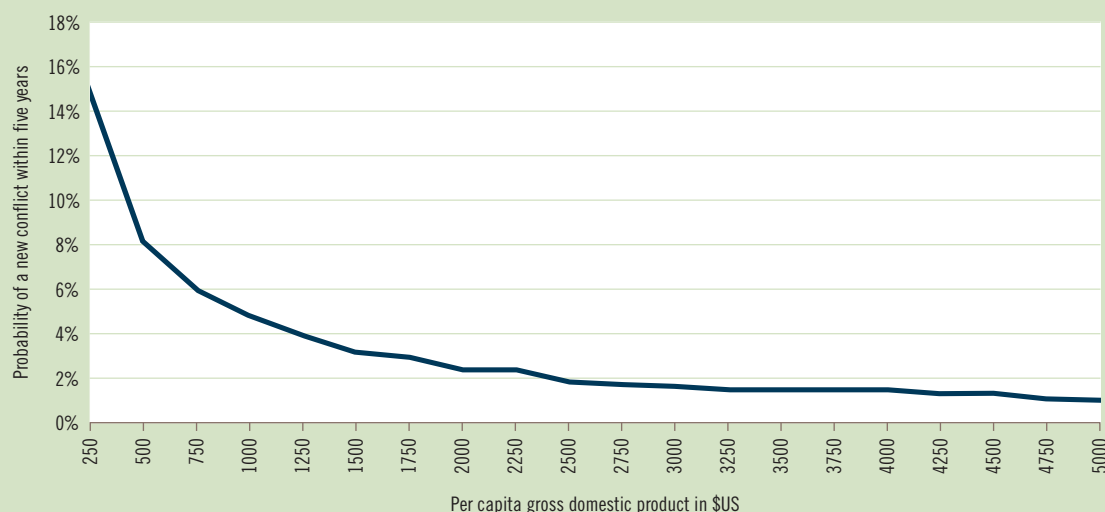
Conflict and poverty. The Human Security Report 2005 demonstrates a striking correlation between war and poverty – the higher per capita income is, the lower the likelihood of conflict occurring (see the figure opposite). It argues that over the long term 'the evidence suggests that the risk of civil war is reduced by equitable economic growth, increased state capacity and inclusive democracy. Development is a necessary condition for security – and vice versa.'

Conflict and international activism. This report also finds a sharp decline in conflict over the nineties – for example, an 80 per cent reduction in the number of civil wars between 1992 and 2002. This sharp reduction is too rapid to be attributed to economic growth, and the report attributes it to increased international activism. This in turn is explained by the United Nations being more active in the post-cold-war era.

Sources: UN (2004) *A More Secure World: Our Shared Responsibility*. The Secretary-General's High-Level Panel on Threats, Challenges, and Change <http://www.un.org/secureworld/report2.pdf>

Human Security Centre (2005) *Human Security Report 2005* <http://www.humansecurityreport.info/HSR2005/Part5.pdf>

THE ASSOCIATION BETWEEN WAR AND POVERTY



BOX 2.3 THE HIV/AIDS CRISIS: PNG'S DEVELOPMENT EMERGENCY

HIV/AIDS is spreading rapidly in the Asia–Pacific region, where it is estimated that there are now more than eight million people living with HIV/AIDS. Four countries in the region suffer from a generalised HIV/AIDS epidemic (with prevalence exceeding one per cent of the adult population): PNG, Burma, Cambodia and Thailand. Several other countries, including the giants China and India, have lower overall prevalence rates but rates of five per cent or more in specific sub-populations such as injecting drug users. And six Indian states already have generalised epidemics.

The example of PNG graphically illustrates the derailing potential of HIV/AIDS. The best available estimate for HIV prevalence in PNG is 0.9 to 2.5 per cent of the population aged 15 to 49 (between 25,000 and 69,000 people) as of November 2004. One estimate has put prevalence in this age group as high as 3.0 per cent (93,000 people) with urban prevalence at 8.8 per cent.

The spread of AIDS is already taking its toll. In 2004, AIDS accounted for 60 per cent of bed occupancy in Port Moresby General Hospital and was the leading cause of adult death in the hospital's medical ward. It is reported that at present one teacher per week dies of an AIDS-related illness in PNG.

The future will be much worse. PNG is currently tracking an HIV/AIDS growth curve similar to that experienced by South Africa and Malawi a decade ago, and several commentators have predicted African-style scenarios of reduced life expectancy, declining growth and severe social impact. Without a decisive intervention now, one recent set of projections indicates that by 2025 there could be over 530,000 people living with HIV/AIDS (i.e. up to 11 per cent of PNG's adult population), over 400,000 cumulative AIDS deaths and 117,000 AIDS orphans.

HIV transmission will be aided in PNG by high levels of other sexually-transmitted infections. Studies have revealed these infections to be as high as 35 per cent among unmarried women and 45 per cent among married women in some communities. Transmission risks are also increased in PNG by widespread transactional sex and rape. Due to gender inequalities, women are particularly vulnerable to HIV and its economic and social impacts such as discrimination and ostracism.

Although the HIV/AIDS epidemic is perhaps the most significant development challenge confronting PNG today, it receives far less domestic attention than it deserves. PNG has so far relied largely on Australia to fund its HIV/AIDS response.

Source: Analytical report on HIV/AIDS.

The Melanesian islands of PNG, Vanuatu, Solomon Islands and Fiji appear to be particularly prone to instability. Analysts point to various factors to explain the higher level of instability in Melanesia relative to Polynesia (Samoa, Tonga and Cook Islands). For example, Polynesia's much better access to developed labour markets and greater ethnic homogeneity, and Melanesia's weak governance and conflicts over natural resources.¹⁹

The Asia–Pacific region faces a growing number of transboundary threats. Asia is particularly prone to natural disasters and is one of the world's regions most vulnerable to infectious disease and environmental degradation, because of its dense, interconnected and rapidly growing populations.²⁰

There are now an estimated 8.2 million people living with HIV/AIDS in Asia and the epidemic is spreading at an alarming rate. The Pacific is

19 Duncan and Chand (2002)

20 FAO (2001)

also affected, with PNG presenting a particularly disturbing scenario. In the absence of vigorous and effective prevention responses, it is predicted that the Asia–Pacific region will account for 40 per cent of all new infections by 2010, threatening to make the region the new epicentre of the global epidemic. While heterosexual transmission, gender inequality and high rates of sexual assault are driving the epidemic in PNG (see Box 2.3), injecting drug use and sex work are the dominant modes of transmission in most parts of East and South-east Asia. Throughout Asia there is an emerging pattern of HIV spread into the general population, particularly to women.²¹

The spread and devastation of HIV/AIDS is long-term and lingering. The impact of pandemics such as avian influenza (bird flu) would be much more immediate and dramatic. The 1918 influenza pandemic killed one to two per cent of the world's population and many experts think we are on the cusp of the next big pandemic. If one does break out, it will likely do so in Asia. As an indication of the economic impact of a pandemic, estimates on the cost of the Severe Acute Respiratory Syndrome (SARS) outbreak range from US\$10 billion to US\$30 billion.

Already, 70 per cent of emerging infectious diseases are zoonoses (i.e. transmitted from animals).²² Continuing population growth, degradation of the natural environment and the intensification of animal production systems all increase the likelihood of zoonotic disease outbreaks. These factors also place a premium on preparedness and response capacities and the maintenance of animal health.

Rapid growth in Asia is also creating tensions over access to natural resources and environmental degradation. Water has often been cited as a source of regional tension. China and India both face acute water supply and quality problems, and China's increased water usage from the Mekong River is causing concern in the downstream countries of

Cambodia, Vietnam and Laos. Pollution from rapid industrialisation is affecting environmental health and air quality. This is leading to a greater incidence of respiratory infections, as is transboundary haze from poor forestry practices in South-east Asia. Increasing demands for energy and resulting climate change are also likely to become more important for development planning in the coming decades.

Recent years have seen natural disasters of extraordinary severity afflict the Asia–Pacific. The 2004 tsunami and earthquakes in the Indian Ocean killed more than 275,000 people and caused up to US\$14 billion damage.²³ China and Bangladesh suffer from regular and increasingly severe flooding. Based on the latest estimates, the recent South Asia earthquake has killed 74,000 people and left 2.5 million people homeless. PNG has suffered from the 1994 volcanic eruption in Rabaul and the 1998 Aitape tsunami. Almost every summer period brings a devastating series of cyclones to the Pacific Islands, and their frequency and intensity could increase due to global warming.²⁴ Managing and responding to natural disasters should be central to any development planning scenario.

DEMOGRAPHIC CHANGE, MIGRATION AND URBANISATION

Profound changes are occurring in the region's population. The United Nations notes that more than half of the world's population already live in Asia and the Pacific and projects that this share will increase to 63 per cent by 2050. It also projects that the Asia–Pacific's share of population over 60 will more than double, from 9.4 per cent in 2000 to 23.5 per cent by 2050. The challenge of an ageing population is particularly acute in Japan, but will also emerge in the next half century in China, Sri Lanka, Thailand and, indeed, Australia.²⁵

In contrast, many of the region's less economically successful countries have the highest population

21 For further discussion on HIV/AIDS see the HIV/AIDS analytical report.

22 Daszak, Cunningham and Hyatt (2001)

23 See US Geological Survey and Munich Re Group websites.

24 Centre for International Economics (2005)

25 Economic and Social Commission for Asia and the Pacific (2005)

growth rates and are experiencing youth bulges. Since gaining autonomy, East Timor has had one of the highest fertility rates in the world with an average of nearly eight children per woman. PNG, Solomon Islands, Vanuatu and the Philippines also have youth bulges, as do the tiny Micronesian states such as Kiribati and Tuvalu. This will place a premium on generating employment-creating growth to avoid worsening poverty levels and growing social tensions.

Asia already accounts for 25 per cent of the world's migrants, with 35 per cent of Asian migrants migrating within Asia. Within the next decade or two, the demographic imperatives of an ageing population in some countries and youth bulges in others will likely lead to increased labour mobility within the region.

The drift of populations to urban centres will continue. By 2015, Asia will be home to 17 of the world's 27 mega-cities.²⁶ Urban growth is an intrinsic part of development – labour released from agriculture through productivity increases provides the resources for growing manufacturing and tertiary sector industries. However, rural–urban migration does give rise to environmental pressures. And if urban growth is not matched by employment opportunities and new industries, social instability is likely to increase. This is a risk for the Pacific as well as Asia. In Melanesia, the combination of youth bulges, urbanisation and lack of employment and migration opportunities is leading to rising crime, particularly among young men. This combination of factors is also a source of political instability as disaffected youth are rallied to support grievances, whether real or perceived. Small atoll countries such as Kiribati are facing particular problems of 'jobless urbanisation.'

AN INCREASINGLY INTERDEPENDENT REGION

In Asia, economic integration is well underway. About 50 per cent of Asian trade is now within Asia. Several bilateral and regional trade agreements

have been forged or are under negotiation. The imperatives of these trade arrangements, as well as World Trade Organization (WTO) accession and membership, are shaping policy and institutional reform throughout Asia. Some subregional connections are also growing. For example, strong trade flows with China are creating an economic growth corridor in the Mekong.

Political linkages are also increasing as the regional architecture broadens. China is continuing to look outward, India is looking to its east and the East Asia Summit process is bringing together the Association of Southeast Asian Nations (ASEAN) membership plus three (China, Japan and South Korea) with India, New Zealand and Australia.

Australia faces a unique opportunity to influence the regional and broader agenda over the next few years through its chairing of the G-20 Meeting of Finance Ministers and Central Bank Governors in 2006, hosting of Asia–Pacific Economic Cooperation (APEC) in 2007 and participation in the East Asia Summit.

2.C THE INTERNATIONAL RESPONSE TO THE CHALLENGE OF DEVELOPMENT

Aid has traditionally been one of the main instruments with which developed countries have responded to the global challenges of development. But aid has fallen as a percentage of donor country national income since the sixties and it fell in real terms from US\$68 billion in 1990 to a low of US\$57 billion in 1997. These trends threatened the relevance and indeed the future of aid. All that has changed in recent years. Heightened awareness of the link between security and development, and that the problems of the developing world can quickly become the problems of the developed world, has marked a watershed in thinking about development.²⁷ This has brought with it a renewed international commitment to reduce global poverty. The decline in global aid levels has been reversed and current expectations are that global ODA will

26 Stanford University (1997); Mega-cities are defined as those with populations of over 10 million people.

27 See also Davis (2005).

increase in real terms to US\$130 billion by 2010. A summary of the focus and commitments made by other major donors is contained in the companion volume of this report.

Much of this increased effort is directed towards sub-Saharan Africa. Countries in sub-Saharan Africa are the major beneficiaries of debt relief provided under the Heavily Indebted Poor Countries (HIPC) Initiative²⁸ and receive the majority of resources pledged under the Global Fund to Fight AIDS, Tuberculosis and Malaria.²⁹ Significant intellectual effort is also being directed to tackling the problem of entrenched poverty in Africa, including through the United Kingdom's 2005 *Commission for Africa Report* and the plans of action for Africa of the World Bank and European Commission.³⁰

By contrast, many donors have withdrawn from parts of the Pacific region altogether (e.g. the United Kingdom and Canada), while many, if not all, international organisations do not give the region the same priority as sub-Saharan Africa. As international financial institutions usually allocate analytical resources on the basis of lending volume, low borrowing regions such as the Pacific struggle to attract significant analytical and policy resources from the World Bank and Asian Development Bank. To a large extent, Australia has had to fill this void.

While traditionally the focus has been on aid, it is recognised increasingly that there are other and probably more important instruments at the disposal of developed countries to promote development. In particular, providing developing countries with access to developed country markets is far more important than providing them with increased aid. Trade generates the vast majority of external resources for developing countries (around US\$2 trillion). In recognition of this, the Doha Round of WTO trade negotiations have been labelled the 'development round'. However, slow progress in these multilateral negotiations, particularly in the important agricultural negotiations, continues to

undermine the realisation of potential gains and is leading to the development of complex, second-best bilateral and regional trade agreements.

2.D AUSTRALIA'S INTEREST AND RESPONSE

Australians possess strong humanitarian values and a deeply held tradition of helping those less fortunate than themselves. The aid program is an expression of those values. Public opinion surveys in Australia have consistently indicated strong support for the official aid program.³¹ Australians have responded generously to humanitarian appeals, most demonstrably after natural disasters such as the Indian Ocean tsunami. There is also support in Australia for the international *Make Poverty History* campaign that has been influential in North America and Europe in pressing for debt relief and greater aid volumes. It is claimed that contributions to non-government organisations (NGOs) by the Australian public have increased to more than \$487 million in 2004 – an annual increase of over 10 per cent since 2000.³²

Strategically, Australia's national interest is intrinsically linked to the Asia-Pacific region. Australia has close economic, political, security and development ties with East Asia and the Pacific. Trade with East Asia now runs at over \$50 billion per annum and Australia is a member of key regional fora such as APEC, the Pacific Islands Forum and now the East Asia Summit.

Australia's future is closely linked to the ability of its neighbours to effectively manage their borders, maintain stability and law and order, and respond to outbreaks of infectious disease. Central to this is the sound functioning of our partners' key institutions of state. Vital also is the ability of countries in the region to grow their economies and provide the necessary opportunities for their populations, particularly the poor, to participate in the economy and raise their standard of living.

28 As at 13 December 2005, 28 countries have reached their decision point under the enhanced HIPC Initiative of which 23 are in Africa and five in South and Latin America. These 28 countries are now receiving relief which will amount to some US\$56 billion over time.

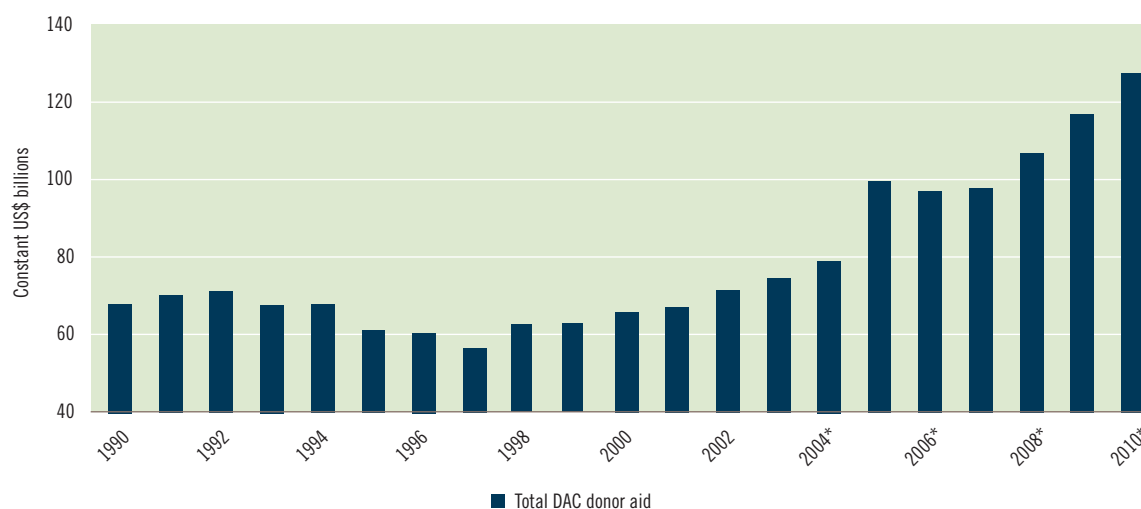
29 61 per cent of the US\$3.9 billion in grants so far awarded by the Global Fund are for Africa.

30 See World Bank (2005a) and European Commission (2005).

31 Newspoll (2005)

32 ACFID (2005)

FIGURE 2.3 GLOBAL AID LEVELS – 1990 TO 2010



Source: DAC International Development Statistics (IDS) Online; OECD DAC Secretariat.

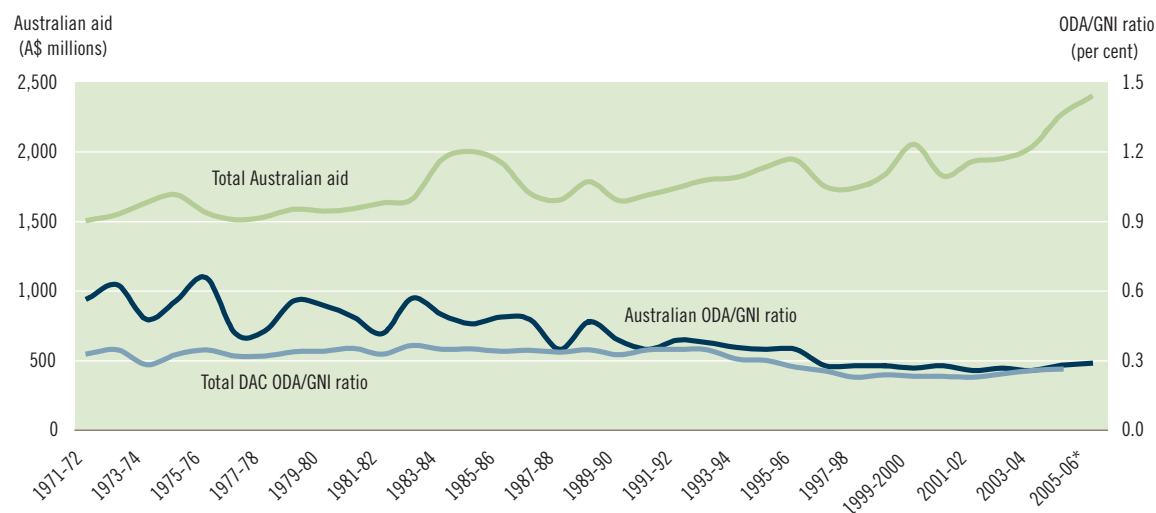
* OECD DAC Secretariat projections.

Figures are Official Development Assistance (ODA) and are in constant 2004 US\$.

Official Development Assistance (ODA) refers to official government overseas aid expenditure (see explanation below Figure 2.4 for further information).

The OECD Development Assistance Committee (DAC) is comprised of 22 of the world's major bilateral aid donors.

FIGURE 2.4 TRENDS IN AUSTRALIAN AID



Source: DAC International Development Statistics (IDS) Online; AusAID Statistical Datamart; Aid Budget Statements.

* Budget estimates only.

Figures are in constant 2004-05 A\$ and are Official Development Assistance.

Official Development Assistance (ODA) refers to official government overseas aid expenditure. For Australia, it includes AusAID bilateral/country programs as well as expenditure through other delivery channels, such as NGOs and multilateral agencies. It also includes eligible expenditure of other Australian government agencies. The OECD Development Assistance Committee (DAC) is responsible for defining what may be recorded as ODA expenditure. The DAC is comprised of 22 of the world's major bilateral aid donors. The ODA to GNI (Gross National Income) ratio is used by the OECD DAC as one means of comparing donor country aid efforts.

Australia's aid program has undergone significant change in recent years. As with other DAC donors, the volume of Australian aid stagnated over the eighties and nineties, but has increased in recent years (see figure 2.4).

In recognition of the importance of improving government performance in the region, Australia has substantially increased its assistance in governance related areas, from \$130 million in 1996-97 to an estimated \$885 million in the 2005-06 Budget. Figure 2.5 shows the changing sectoral shares of Australia's aid. The share of governance has increased from nine per cent in 1996-97 to 36 per cent in the 2005-06 Budget. Expenditure shares for infrastructure and rural development have fallen while, taken together, health and education shares have remained fairly constant. Whereas in 1996-97 spending on governance was less than spending on education, infrastructure or rural development, it is now greater than any of these by a multiple of two or more.

Australia has also become more engaged, hands-on and pro-active in its approach to governance weaknesses in the region. Deep-seated concerns over governance and law and order failings in Solomon Islands, which not only were undermining growth and poverty reduction in Solomon Islands but also posed serious spill-over consequences for its neighbours, were the driving force for Australia leading the Regional Assistance Mission to Solomon Islands (RAMSI).

RAMSI was also a recognition that the problems in Solomon Islands required more than an aid response. The 'whole-of-government' (or multi-departmental) approach which RAMSI embodies is also an increasingly important feature of the broader aid program. This is most evident in PNG and Indonesia, as well as in responses to transboundary and regional issues in Asia and the Pacific. Consequently, government agencies other

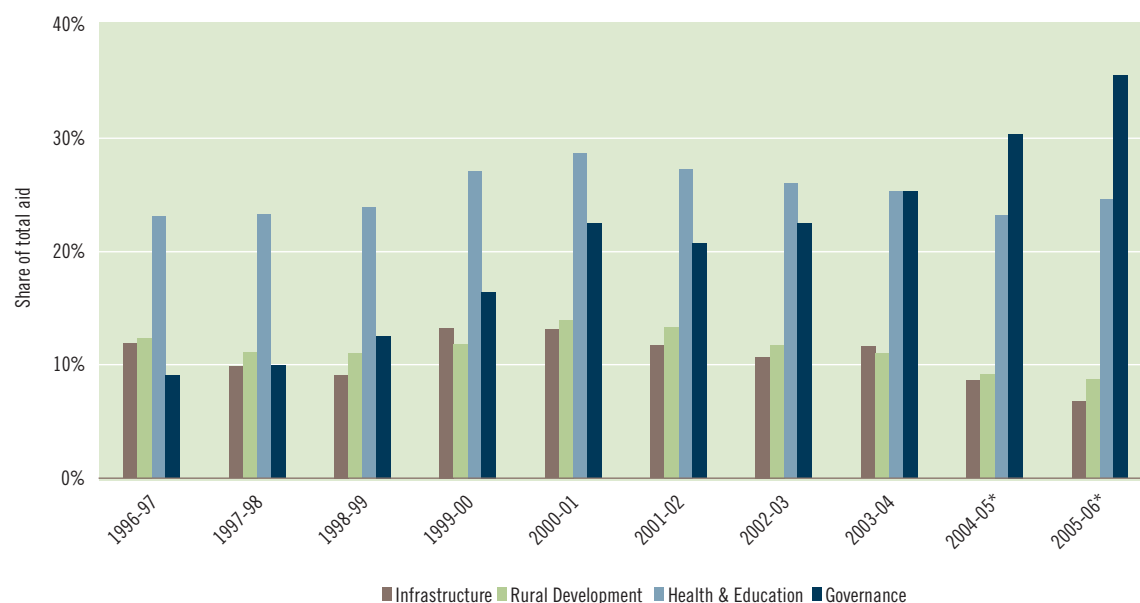
than AusAID have become increasingly important in the delivery of ODA. As Figure 2.6 shows, expenditure by agencies other than AusAID rose from 6.1 per cent of ODA in 1996-97 to a budgeted 24.6 per cent in 2005-06.

The Asia-Pacific region has consistently absorbed around 90 per cent or more of Australia's bilateral aid budget. In recent years this focus has further sharpened. In the 2005-06 Budget, the three largest recipients – Solomon Islands, PNG and Indonesia – were budgeted to receive 56 per cent of the bilateral aid budget.³³ This reflects important recent initiatives in these three countries. RAMSI has pushed up Solomon Islands' aid support from just \$34 million in 2002-03 to a budgeted \$247 million in 2005-06. The Enhanced Cooperation Program (ECP) with PNG was a bilateral but similarly whole-of-government initiative, though its future scope is uncertain following a court challenge in PNG. The \$1 billion Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) represents another watershed in Australia's engagement with the region. It is the largest single aid package in Australia's history and demonstrates Australia's ongoing commitment to its most populous neighbour.

The recent announcement of increased aid positions Australia well to help the Asia-Pacific region address its development challenges over the next 10 to 15 years. To maximise the returns from this increased investment, Australia must learn from past experience and development research.

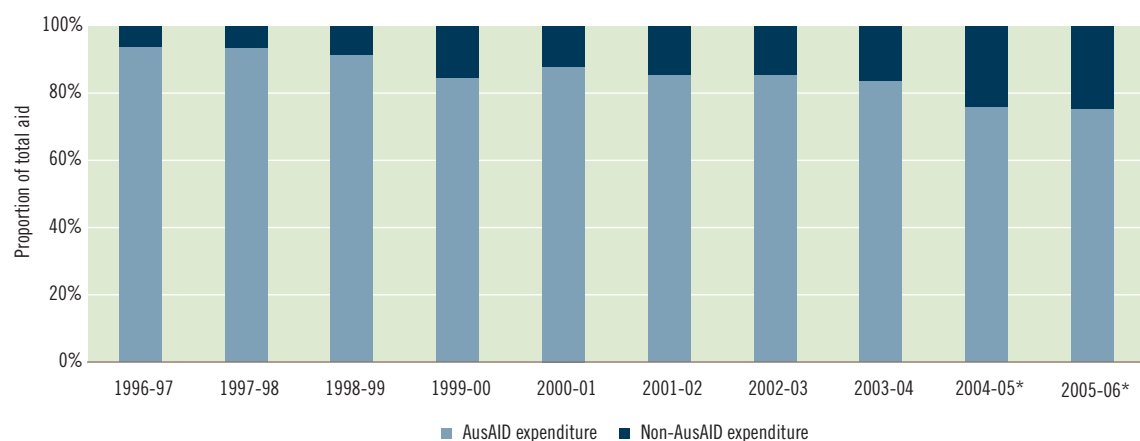
33 For the purposes of this comparison, 'bilateral aid budget' refers to total Official Development Assistance (ODA) that is attributable to specific countries or regions.

FIGURE 2.5 AUSTRALIAN AID BY SECTOR



Source: AusAID Statistical Datamart, Aid Budget Statements.
 * Budget estimates only.
 Figures are Official Development Assistance (ODA).

FIGURE 2.6 PROPORTION OF AUSTRALIAN AID ADMINISTERED BY AUSAID AND OTHER AGENCIES



Source: AusAID Statistical Datamart, Aid Budget Statements.
 * Budget estimates only.
 'Non-AusAID' includes ACIAR.
 Figures are Official Development Assistance (ODA).

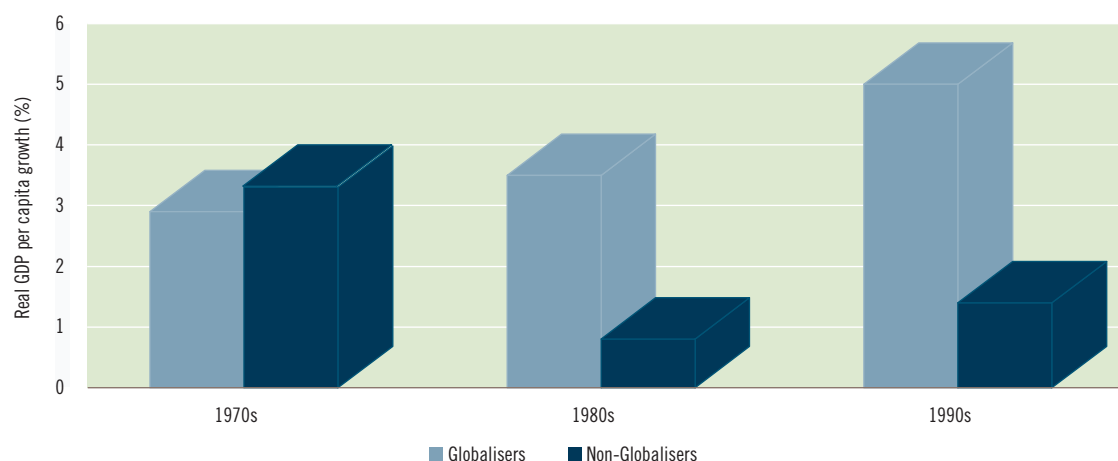
3 International Development Thinking and Lessons

This chapter discusses the lessons learnt on development in general, and aid effectiveness in particular, and concludes with a brief analysis of Australia's aid program.

3.A DEVELOPMENT LESSONS

Experience shows unequivocally that economic growth is the key to poverty reduction. This is illustrated by the contrasting experiences of sub-Saharan Africa and Asia brought out in the last chapter, with the latter's consistently higher growth rates underlying its significantly more rapid poverty reduction.

FIGURE 3.1 GROWTH RECORDS OF GLOBALISING AND NON-GLOBALISING COUNTRIES



'Globalisers' represent the top third of a group of 72 developing countries for which data was available, ranked by increases in their trade to GDP ratio between the mid-seventies and the mid-nineties.

'Non-Globalisers' are the two-thirds with the least increase in their trade to GDP ratio.

Figure 3.1 Growth Records of Globalising and Non-Globalising Countries
Source: Dollar and Kraay (2004).

What leads to growth in developing countries?

Integration with the global economy is extremely important. Countries that have opened themselves to greater trade and investment have grown more quickly than those that have not (Figure 3.1). In all countries that have sustained growth, the share of trade in gross domestic product has increased and trade barriers have been reduced.³⁴ East Asia's economies in particular have been outward-oriented and their rapid growth has occurred on the back of extremely rapid export growth.

There is also an increasingly strong body of research that finds that appropriate and effective institutions are essential drivers of long-term growth. Institutions that provide dependable property rights, manage conflict, establish macroeconomic stability, align economic incentives with social benefits and maintain law and order are an important foundation for long-term growth.³⁵

Recent research, however, has also emphasised country specificity and the variety of ways in which the general institutional pre-requisites for successful development can be met. It is now clear that local histories and experiences count, and that simply transplanting institutional models from other countries – usually advanced Western economies – does not guarantee success. The World Bank, in its comprehensive study of growth in the 1990s (summarised in Box 3.1), concludes 'each successful country was successful in its own way'.

While growth is essential, it is not the only determinant of poverty reduction. Resource rich countries such as Nigeria, Sierra Leone and PNG have experienced periods of high growth without notable improvements in living standards. Pakistan tripled its per capita income between 1950 and 1990 but its basic social indicators remained some of the worst in the world.³⁶ Providing opportunities for everyone to participate in growth is also critical. In some countries this has been done through land reform, in others by the wide provision of basic education and health services and by the pursuit of gender equity. The 2006 *World Development Report* emphasises the importance of equity for development, arguing that greater equality of

BOX 3.1 ECONOMIC GROWTH IN THE 1990S: LEARNING FROM A DECADE OF REFORM

During the 1990s, many countries pursued strategies to contain the role of the state, integrate with the world economy, and promote macroeconomic stability and a supportive business and investment climate (including the ability to enforce property rights). It was believed that these reforms would bring about the economic growth necessary to make inroads into poverty reduction.

Results were mixed. Some countries exceeded expectations while others fell well short. Some achieved sustained growth with modest reforms, while others did not grow in spite of implementing wide-ranging reforms.

Analysis of this experience confirms the association of macroeconomic stability, a supportive business and investment climate and openness with sustained growth, but recognises that there are many institutional and policy paths to achieve these conditions. Since attempts to apply uniform policy packages have not translated consistently into growth across countries, the priority should be to support the development of country-specific strategies that address high-priority or 'binding' constraints to growth. If such targeted strategies are to be effective, they will need to recognise individual countries' political and social as well as economic specificities.

Source: World Bank (2005b)

opportunity for all citizens would not only provide poorer groups with more opportunities but would also accelerate aggregate growth (see Box 4.1).

3.B DEVELOPMENT ASSISTANCE LESSONS

International thinking on aid has changed markedly over the past decade, reflecting growing knowledge of what makes countries successful and the mixed experience, good and bad, with aid. In this section

34 World Bank (2005b)

35 Rodrik (2003)

36 Easterly (2001)

BOX 3.2 AID AND GROWTH: AN ONGOING CONTROVERSY

Given the centrality of economic growth to poverty reduction, the issue of whether and under what conditions aid promotes growth has attracted enormous attention over the past decade. An influential 1998 World Bank report *Assessing Aid: What Works, What Doesn't and Why* found that aid led to higher growth in good policy environments. A large number of subsequent studies has re-examined this issue and emerged with a range of contradictory findings. The debate shows no sign of resolution. In mid-2005, just when one set of researchers (McGillivray et al. 2005) concluded that the controversy over whether aid leads to growth was settled (it does), another group (Rajan and Subramaniam 2005a) found there is no robust relationship between aid (however defined) and growth. Why is it that the issue is so difficult to resolve? There appear to be two principal reasons.

First, all the studies are based on cross-country regressions, an approach which has often led to findings that are not robust and that face a myriad of methodological problems (Pritchett 2000). In particular, even if one thinks that aid is likely to have a positive effect on growth, it is unlikely to be large given that aid volumes are not large for many countries. So any positive relationship might be drowned out by 'noise' in the data. Moreover, not all aid is given to accelerate growth. Clemens, Radelet and Bhavnani (2004) isolated the forms of aid that are intended to accelerate growth, and found they do have a positive impact.

Given that some analysts have found it difficult to isolate a relationship between growth and investment, it is not surprising that others

have been unable to find a robust relationship between growth and aid (which is usually only a fraction of total investment). But no-one has concluded that investment is unimportant for growth. Rather, it has been argued that its importance is overshadowed by other more primary determinants such as domestic policy and institutional settings.

Second, some aid interventions might be poorly designed or implemented, or have damaging economy-wide impacts. Rajan and Subramaniam (2005b) have argued that aid may reduce the competitiveness of the traded goods sector through causing an appreciation in the real or nominal exchange rate (this is the long-standing 'Dutch disease' effect associated with large foreign exchange earnings from resources). Others have argued that aid dependency weakens institutional quality through its negative incentive effects (this is known as the 'rent-seeking' argument – see Knack (2000) and Ruhashyankiko (2005)).

What lessons can be drawn from this vast and contradictory literature? In terms of future research, we need to look more closely at individual country experiences in order to better understand the impact of aid on growth rather than relying so much on cross-country regressions. In terms of policy implications, more attention should be given to aid effectiveness and the design of aid programs should attempt to minimise any negative macroeconomic impact. Many of the recommendations of this report are made with this in mind.

we summarise lessons learnt on the relationship between aid and growth; the record of aid in improving governance; approaches to fragile states; aid delivery mechanisms; and aid evaluation.

AID AND GROWTH

There is a substantial but inconclusive body of research on the relationship between aid and growth (Box 3.2). There is, however, widespread

agreement that aid is only one small part of the growth picture. Much more important are developing country policies and institutions. Developed country policies other than aid also matter, including trade and immigration policies. Although their relative importance will vary from country to country, these other policies will often matter a lot more than aid. But, if used well, aid can help countries strengthen their institutions and exploit the opportunities afforded by greater openness.

AID AND GOVERNANCE

Responding to the growing consensus that sound institutions are the basis of national prosperity, donors have invested heavily to promote reform and build capacity for good governance in developing countries. Yet the record of this support has been mixed. Understanding the factors that underpin successful endeavours to improve governance and how aid programs can support them has been subject to significant research over the years. One of the main findings of this research has been that timeframes have been too short and expectations too ambitious – changes in capacity and performance may take generations, and certainly longer than the span of a three to five year aid project. Too much effort has been given to simply transplanting institutions from elsewhere, with insufficient attention to understanding the internal incentive structures and cultures that influence behaviour. For example, performance-based public service recruitment and promotion reforms are often recommended without a full understanding of how they might be undermined by traditional and cultural affiliations. And not enough recognition has been given to the need for reform to be owned and driven locally.

Donor agencies have often relied on technical assistance to improve governance, but with mixed results. The World Bank's Operations Evaluation Department concluded from a review of its capacity building efforts in Africa that, 'The Bank's traditional tools – technical assistance and training – have often proved ineffective in helping to build sustained public sector capacity.'³⁷ Similarly, a review by the United States of their law and justice technical assistance efforts over the eighties and nineties concluded that 'what stands out is how difficult and often disappointing such work is'.³⁸

Technical assistance has been successful in areas such as agriculture, health, population and high technology where it has transferred 'technical procedures into non-politicised environments'.³⁹ Conversely, technical assistance is less likely to succeed when capacity weaknesses are caused by misaligned incentives and political dysfunctionality.

Technical assistance can be important in fragile, non-reform environments for providing some capacity on the ground to deliver services including through non-state providers. But traditional approaches to government capacity building are particularly unlikely to be effective in fragile states.⁴⁰ This is for two reasons. First, the weaker the existing capacity, the harder it is to transfer skills. Second, the poorer governance is, the less likely it is that the problem is a lack of technical skills, and the more likely that the problem is one of dysfunctional politics.

Together, these insights are encouraging donors to embrace new approaches to governance. They emphasise that aid-funded programs should focus on a limited number of priorities and emphasise 'good enough' rather than 'best practice' governance principles.⁴¹ These approaches also rely less on technical assistance.⁴² Since the lack of political support for development and reform is usually the Achilles' heel of reform efforts, greater effort is being devoted to understanding the political context of reform in developing countries. And since external conditionalities have limited potency, donors are starting to look at how to encourage and help local people to express their own demand for better services and performance. Finally, while the focus is normally on how aid might improve governance more effectively, aid agencies are paying greater attention to the danger of fostering aid dependency and thereby undermining governance through rent-seeking and reduced domestic accountability (see Knack 2000 and Box 3.2 above).

37 World Bank (2005c)

38 Carothers (1999) quoted in Unsworth (2005).

39 Morgan (2002)

40 Chauvet and Collier (2004) provide backing for this conclusion through their recent econometric analysis of technical assistance effectiveness in fragile states. They conclude that 'Technical assistance has no discernable effect until after a turnaround [improvement in government performance] has clearly begun. Before that, it appears to be a waste: it is not a pre-condition for reform.' See also Steedman (1995).

41 Grindle (2004)

42 A recent Asian Development Bank report (2005) has, for example, recommended the Bank reduce the number of new technical assistance activities it supports.

FRAGILE STATES

There has been a watershed in international thinking on approaches to poorly governed and often unstable countries, particularly in the post-9/11 environment and following the sobering experiences of Somalia, Kosovo and Rwanda. Depending upon definitions, there are now anywhere between 30 and 46 so-called ‘fragile states’, involving a combined population of up to 900 million people.⁴³

These countries are caught in a vicious cycle in which weak governance and institutions, poor service delivery, a stalled economy and instability all combine to erode state legitimacy, breed greater instability, drive investors further away and drive the economy further down. Moreover, fragile states impose significant spill-over effects on other countries, in the form of exposure to conflict, refugees, disease, transnational crime and broader security weaknesses.⁴⁴

While the influential 1998 study *Assessing Aid: What Works, What Doesn't and Why*⁴⁵ argued for performance-based aid allocations on the basis that aid works best in good policy and institutional environments, more recent thinking underlines the need to find effective approaches to fragile states. In such contexts, while aid can do harm as well as good, abandoning poorly-performing states is unlikely to lead to any improvement in performance. Research has found that fragile states remain fragile for a long time (on average around 56 years)⁴⁶ and experience suggests that fragile states have little chance of improvement without outside intervention.

Bilateral aid agencies and the multilateral banks have recognised that traditional approaches to fragile states have been disappointing – reform cannot be enforced through conditionality and nor can it be ‘bought’, even by large promises of aid from bilateral or multilateral development agencies. Experience also shows that nation-building cannot be subcontracted to aid programs alone. Security,

political and economic engagement may also be required, as is shown in Solomon Islands. But the international evidence also suggests that aid is often an essential part of the overall package of successful engagement with fragile states.

AID DELIVERY MECHANISMS AND COUNTRY OWNERSHIP

There is now much greater acceptance and recognition of the need to work through developing country policies and systems for aid to be effective. Results from aid are more positive if programs are owned and driven by the recipients. Ad hoc projects implemented directly by donors outside of partner government systems have struggled to become sustainable. Further, donors have been guilty of overburdening already strained partner governments with too many uncoordinated activities involving significant transaction costs. In response, aid agencies have moved to introduce and accelerate the use of aid modalities that seek to align with partner government systems and budgets and that are coordinated or harmonised with other donors. This commitment was formalised in the 2005 Paris Declaration on Harmonisation and Alignment (Box 6.4). It should be noted, however, that alignment with government does not mean implementation by government. There is also increasing recognition of the role the private sector and other non-state actors can play in service provision and aid agencies are increasingly trying to work with and through these alternative service providers.

AID EVALUATION

Finally, it is worth emphasising that one important lesson from recent experience in aid is the need to pay much more attention to evaluations of aid, an area that has been neglected in the past. As one recent study noted, ‘While the goals may be clear –

43 For further coverage see Anderson (2005).

44 Chauvet and Collier (2004) estimate that the average cost (in terms of negative GDP impact) of being a neighbour of a fragile state is US\$ 80 billion.

45 World Bank (1998)

46 Chauvet and Collier (2004)

improving health, increasing educational attainment, reducing poverty – the documented record of specific social interventions that succeed is relatively sparse.⁴⁷ There is now much more attention being given to closing this ‘evaluation gap’. There is also an increase in studies on aid impact at both the micro and macro level. Attention to aid effectiveness will only expand as aid budgets increase.

3.C THE AUSTRALIAN AID EXPERIENCE

The 2004 OECD Development Assistance Committee (DAC) Peer Review of Australia reported positively on Australia’s leading role in the region on fragile states, HIV/AIDS, humanitarian and post-conflict assistance, and whole-of-government approaches. Australia is a leader in its incorporation of whole-of-government approaches, as witnessed in interventions in Solomon Islands and PNG and in response to the tsunami disaster in 2004. The country analytical reports commissioned as an input for this report also provided positive feedback. For example, consultations undertaken in preparing the Indonesia analytical report highlighted that Australia is seen as a flexible and responsive donor. Innovative approaches to the provision of demand-driven technical assistance, including in economic governance and in the legal area, were particularly highlighted.

Other strengths of the aid program include its long-standing emphasis on scholarships. This pre-dates but fits in well with the recent recognition that reform and improved performance must be driven from within through a cadre of highly competent and educated leaders.⁴⁸ Australia’s aid has also intervened effectively in a number of specific areas including land-titling programs in South-east Asia and more recently, de-mining. A recent evaluation has also found positive benefits of Australia’s investments

in agricultural research through ACIAR.⁴⁹ And Australia has an impressive record of rapid and generous support for the victims of humanitarian crises and disasters, both within our region and globally.

What lessons does the Australian aid program teach us vis-à-vis the five areas discussed in the previous section: growth, governance, state fragility, aid delivery mechanisms and evaluation?

In PNG and the Pacific, as the analytical reports show, growth has been disappointing despite high levels of aid support. To be sure, there have been successes – social indicators have risen much faster in the Pacific than in sub-Saharan Africa, and an independent review of Australian aid to Papua New Guinea in 2003 found that without Australian aid some areas of PNG would have no access to essential goods and services.⁵⁰ The aid program also played a key role in resolving the Bougainville conflict and building peace in Solomon Islands. Still, the Pacific, though not as poor as Africa, is a region which is making little progress on the whole in terms of growth or social development. It is characterised by instability and fragility, and shows even higher aid dependency than sub-Saharan Africa.

As stated earlier, economic outcomes are, of course, dependent on many other factors aside from aid. It is very difficult to determine a counter-factual for the Pacific in the absence of aid, and unconvincing to assert that the region would be better off without aid. One can certainly agree, however, with the assertion in the Pacific analytical report that aid has not had the impact in the region that one would have hoped for.⁵¹

With respect to the impact of aid on the quality of governance, Australia was quick to spot the need for further investment in this area and has rapidly expanded spending in support of governance

47 Savedoff, Levine and Birdsall (2005)

48 Key alumni of Australian aid scholarships include the former Indonesian Finance Minister, the Vice President and a number of senior ministers in Vietnam, the current Central Bank Governor of Solomon Islands, and senior public health technocrats in Cambodia, to name a few.

49 Raitzer and Lindner (2005) found that ACIAR’s investment in bilateral research over the past 22 years has more than paid for itself. This review of returns on ACIAR’s bilateral research and development investments determined that returns in benefits to end-users throughout the Asia-Pacific, from less than 10 per cent of ACIAR’s project investments, have surpassed the total bilateral investment of \$1.1 billion over two decades.

50 For instance, it is estimated that the number of PNG children attending school in PNG in the ten years to 2000 doubled as a result of Australian aid. See AusAID (2003a).

51 For other views on this, see Feeny (2004) and Hughes (2003).

reforms, as noted in the previous chapter. A recent review of support on capacity building in public finance found that much of this increased assistance has had a solid impact.⁵² In particular, the review found that the most successful programs were those that linked their activities to organisational and national visions for change, and had the flexibility to take account of changes in organisational resources. Post-crisis governance interventions in Indonesia also had strong, positive impacts.⁵³

Australia has, however, shared the rest of the donor community's frustration at the limited impact of technical assistance as a means of building capacity and embedding reform, especially in the more fragile states of the region. A dilemma for Australia and other donors is how to respond to the governance deficiencies in the very weakest states, where human

resources can be so limited that technical assistance is needed simply to undertake the core functions of government, such as preparing a budget. The Australian program has already begun to shift its approach towards improving its governance programs. Throughout the region, increasing use is being made of experts seconded from the Australian public service. In addition to ensuring a supply of skilled and experienced practitioners, this helps build long-term organisational relationships between Australian government departments and their counterparts in the region and so is expected to lead to a more durable strengthening of capacity. There is, however, some way to go in rethinking the aid program's approach to governance and heavy reliance on technical assistance, a theme we return to in Chapter 5.

BOX 3.3 NEW APPROACHES TO AID DELIVERY IN INDONESIA: LEARNING ASSISTANCE PROGRAM FOR ISLAMIC SCHOOLS (LAPIS)

LAPIS adopts an approach that differs significantly from the traditional project. For a start, its objectives are at a macro level (to enhance the quality of Islamic education) and its approach is to address comprehensively a range of impediments to development.

LAPIS emphasises the importance of building relationships and understanding the sector and region early on, before proceeding to map out longer-term activities to support over a five-year period. In developing these activities, AusAID is seeking opportunities to work collaboratively with national, district and local authorities as well as with other development partners such as aid agencies, and non-government and community-based organisations.

LAPIS addresses the specific needs of Islamic schools, which provide education to an estimated 15 per cent of school age children (about 8.5 million students) in Indonesia. Enrolments are growing, particularly from the poorer sectors of the community and from young women and

girls. But the quality of teaching and learning in these schools is low, with teachers often poorly trained and paid, facilities basic and resources scarce. Since its inception in mid-2004, LAPIS has set about building relationships and mapping this sub-sector. It has invested in short-term pilot activities in 12 locations and is now developing a comprehensive package of support including school infrastructure, school-based management and upgrading the skills of teachers.

It is still early days for LAPIS, and certainly too early to judge its success. But the LAPIS approach has been well received by Islamic communities and by senior figures involved in Islamic education in Indonesia. Most notably, Asyumadi Azra, Rector of the State Islamic University of Jakarta, who commented, '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.'⁵⁴

52 AusAID (2004a)

53 Stoekel (2003)

54 Republika Online (2005)

On engaging with fragile states, because of the number of fragile states in our region the Australian program has been propelled to the frontiers of thinking on how to operationalise the new insights. Australia has joined other leading donors in a major program of research on how to improve approaches – a case study of the Regional Assistance Mission to Solomon Islands will provide one of the few success stories.

On aid modalities or delivery mechanisms, Australian aid is moving away from stand-alone projects to broader sectoral programs more integrated with partner governments' own systems and policies. New sector-wide programs in health, education and infrastructure are in development in various countries. Australia has not, however, embraced unconditional budget support following the disappointing results from its use in earlier years in PNG. Acknowledging the complexity of many of the problems with which the Australian program is engaged, new ways are being developed to ensure that projects and programs are relevant and well-targeted. More up-front time is being dedicated in program development work to understanding the underlying issues and building the major relationships. A good example of this is provided by the Learning Assistance Program for Islamic Schools (LAPIS) in Indonesia (see Box 3.3). Progress has also made on the 'untying' agenda – opening up of participation in Australia's aid program to non-Australian companies. In Chapter 8 we return to untying and recommend completion of the process.

Australia, like other aid donors, has found it difficult to adopt the right approach to aid evaluation. AusAID has a strong record of accountability to Parliament for the aid program, as confirmed by a number of Australian National Audit Office (ANAO) reports.⁵⁵ In addition, a number of useful and influential evaluations have been conducted (Box 3.4 provides a sample). Nevertheless, the body of high quality and rigorous evaluation work on Australia's aid program is not as strong as it could be, both internally and from external parties. As more experimentation takes place, and as Australia's aid budget is set to increase, it is important that more attention be given to aid effectiveness and to learning the lessons of experience.

In conclusion, we believe that Australia has a strong and relevant aid program. It operates, with major programs and an important donor role, in diverse contexts, from the microstates such as Tuvalu to Indonesia, a country in the early stages of democracy and with the world's fourth largest population. At the same time, the large announced increase in the aid budget will in itself usher in many changes. Steps need to be taken now to ensure that this increase is used productively and does not undermine effectiveness. These are the challenges we address in the chapters which follow.

55 For example, see ANAO (2002) and ANAO (2003)

BOX 3.4 INFLUENTIAL AUSAID REVIEWS AND EVALUATIONS

Capacity Building in Public Finance (2004)

reaffirmed the importance of linking activities to organisational and national visions for change, and maintaining flexibility to take account of changes in organisational resources. This is particularly relevant in the Pacific, where the limited supply of skilled staff for key positions can bring projects to a standstill. To address this problem, the report recommends multi-skilling appropriate staff to build a cohort of potential replacements.

Independent Review of Australia's Aid Program to PNG (2003a) endorsed several aspects of the PNG program and concluded that without Australian aid some areas of PNG would have no access to essential public goods and services. The review made recommendations on enhancing public expenditure management, improving the program's performance framework and continuing efforts to improve donor coordination. Australia and PNG are working on a new country strategy to take account of the review's recommendations and Australia has already announced the untying of aid to allow PNG firms to tender for aid contracts.

PNG and the Pacific: A Development Perspective (2003d) commented on the development performance of the region, noting that on a number of social indicators the Pacific performed significantly better than sub-Saharan Africa and was reaching Caribbean standards. Yet economic performance was poor, especially in the Melanesian region and on a per capita basis. The report pointed to four areas where aid may have had a deleterious effect: i) in helping concentrate economic activity in capital cities; ii) by contributing to the inflated size and cost of the public sector; iii) weakening of public sector structures by an emphasis on project delivery; and iv) by sometimes adding inappropriately to the size

of the recurrent budget (e.g. through provision of roads and schools without proper consideration of ongoing operating costs). The report contributed to a more informed discussion on development prospects and appropriate aid interventions in the Pacific.

Incentives and the Australian Aid Program (2003c) found that, given the amount of aid funds then available, Australia was unlikely to effect government-wide reform in partner countries. Incentives were found to work best when entities competing for funds were judged on the direction of improvement rather than on absolute changes. In the absence of such judgements there is little incentive for poor performers to reform. The report also found that sector-wide approaches and technical assistance facilities lend themselves to good use of incentives and contestability. The report led to the issuing of guidelines on how to incorporate incentives into the design and implementation of aid programs. (See also Box 6.2.)

Review of the Secretariat of the Pacific Community (SPC) (AusAID 2001a) noted that the organisation was reasonably relevant, efficient and effective, but highlighted problems due to a lack of secure funding arrangements. It recommended that donors provide secure longer-term funding commitments for the SPC to enable more effective and strategic planning of its programs, and recommended that a greater proportion of the funding be untied. Related to this, other recommendations aimed at developing a quality assurance program. As a result of this review, AusAID untied its funding to the SPC and the SPC strengthened its quality assurance systems. This is now a model for other regional organisations in the Pacific.

4 A Strategic Framework for Australia's Aid Program

In this chapter, we start with the objective of Australia's aid program – 'to advance Australia's national interest by assisting developing countries reduce poverty and achieve sustainable development'.

Based on the analysis of the preceding chapters, we then turn to the development of a new strategic framework for use by the aid program in its pursuit of this objective.

4.A OVERALL OBJECTIVE OF THE AID PROGRAM

The current objective of the aid program was framed in response to a growing critique during the mid-1990s that Australian aid had become weighed down by a variety of competing short-term and, in particular, commercial interests.⁵⁶ The current objective has served the aid program well. It is a sign of its beneficial impact that it now seems remarkable that in 1997 AusAID country strategy papers had to 'indicate how the proposed program will serve Australia's trade interests'. This is no longer the case.

The objective has, in recent years, come in for criticism on two grounds. First, the reference to the 'national interest' has been questioned by some. The recent Organisation for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) Peer Review of AusAID perceived

the risk 'that the national interest dominates the development agenda and results in a security rather than a poverty driven agenda.' Indeed, during our consultations we were struck by how the use of the phrase 'national interest' was regularly misinterpreted as promoting some narrower self-interest at odds with the broader goal of poverty reduction. In this regard, it is useful to quote from the Minister for Foreign Affairs' statement at the time when the aid objective was formulated, in particular, the argument that 'an effective and well-targeted aid program, focusing on the alleviation of poverty and the promotion of sustainable development, is clearly in the national interest.'⁵⁷ This argument is as relevant today as it was when first made in 1997. Indeed, as we have noted in Chapter 2, the links between development and the national interest are much more evident today than they were even a few years ago. It is now widely recognised that Australia and its citizens will not be safe in an unstable region or world and that poverty and inequity undermine stability.

Australia's national interest and poverty reduction are not two separate agendas for the aid program. Rather, the objective calls on the aid program to advance the former by pursuing the latter. This needs to be communicated better to both domestic and international audiences.

56 Downer (November 1997)

57 Ibid p.5

Where the national interest does legitimately and directly shape the aid program is in regard to the countries in which Australia invests its aid dollar. The geographic focus on the Asia–Pacific region was endorsed strongly by the recent DAC Peer Review, which viewed it as consistent with effectiveness and a division of labour among aid agencies. It also makes sense given Australia’s long and extensive ties with the countries of the Asia–Pacific and the fact that, as pointed out in Chapter 2, other donors have left or reduced their presence in the region. In fact, we would argue that in the interests of more strategic donor coordination all donors should strengthen the geographic concentration of their programs.

The other objection to the current aid program objective is that it does not make reference to the Millennium Development Goals (MDGs, Box 2.1). Clearly, when the current mission statement refers to the reduction of poverty, it is not referring only to income poverty, that is, only to the first of the eight MDGs. Rather, it must be recognised that the poverty reduction sought is multi-dimensional, involving improvements in health and education as well as increases in income. To our mind, the mission statement could equally be cast in terms of poverty reduction or achievement of the MDGs. The current form has the advantage of simplicity and of avoiding development jargon, while being consistent with Australia’s active support for the achievement of the MDGs.

Many in our public consultations stressed the importance of the MDGs and the need to better link the Australian aid program more closely to them. We agree. The MDGs are certainly useful as a set of widely accepted goals to which Australia and many other countries subscribe. They help communicate to the public the direction, importance and ambition of the global development effort. The MDGs also provide very useful targets against which development and aid efforts can be assessed, both globally and in countries that adopt them for themselves, nationally. We suggest that AusAID give greater emphasis to the MDGs in these regards and avoid needless suspicion that somehow

Australia is not committed to the MDGs. The recent AusAID report that explained how the aid program contributed to progress against the MDGs was useful in this respect.⁵⁸ Where there is demand, AusAID should assist in regional and/or national efforts to report progress against the MDGs.

4.B A STRATEGIC FRAMEWORK FOR THE AID PROGRAM

There are a myriad of policies, strategies and program priorities that could be pursued in seeking to achieve the overarching objective of Australia’s aid program. It is critical that the aid program has a clearly articulated and well understood vision for how strategies will be developed, choices made and programs implemented over the coming years.

Such a vision or overarching policy framework should:

- > be coherent
- > be based on what has been learnt about development and aid
- > acknowledge that country settings and priorities should be the starting point for any decision on strategies and interventions, while recognising that, in an inter-linked world, threats to development and their solutions are increasingly regional or global rather than only national in nature
- > be relevant for the entire aid program rather than only AusAID.

Based on the analysis summarised in the preceding two chapters, we believe that **four core themes** should provide the guiding framework for Australia’s aid program over the next 10 years. The Australian aid program should seek to:

- > accelerate economic growth
- > foster functioning and effective states
- > invest in people
- > promote regional stability and cooperation.

58 AusAID (2005)

While there can be debates over prioritisation, sequencing and targeting, lasting and sustained development and poverty reduction must see progress on all four fronts since all four are interlinked. Economic growth both requires and promotes human development. Neither economic growth nor human development will be possible if the basic architecture of statehood is non-functional. And domestic governments cannot fulfil their core functions in the absence of regional stability and cooperation. Individual country strategies, at least for the larger aid partners, will need to consider progress and programs in all four areas to determine the most effective contribution that Australian aid can make. This does not mean that Australian aid should focus equally in all countries on all four elements. Selectivity is very important, but it will need to be exercised with an awareness of the broader efforts of the partner government, other donors and international organisations in all these four areas.

WHY ECONOMIC GROWTH?

Growth has been and will continue to be the main driver for development and poverty reduction. Underlying the impressive export-led growth performance in the Asia-Pacific region are severe disparities between and within countries. These are likely to grow over the medium term if current trends continue. For many countries in Australia's immediate region, such as Indonesia, generating sufficient growth to make inroads into poverty and reinforce the legitimacy of their democratic governments is the core challenge over the next decade. To reduce poverty and unemployment, and to strengthen stability, growth needs to be employment-intensive. To be sustainable, growth needs to confront a number of environmental challenges. While the approach should be to support policies and programs to generate increases in aggregate growth and employment, there may also be a need in special circumstances to target groups and regions that, for whatever reason, are not benefiting from broader growth gains.

The consistency of the analytical reports on the need for the aid program to do more to promote growth was remarkable. The main recommendation of

the PNG report was to 'position the aid program to support growth.' The Indonesia report recommended that the aid program needs to 'scale up the growth agenda.' The Pacific report argued that the aid program 'needs to develop more effective ways of addressing and integrating this growth objective.' And the Asia report argued that Australia should 'significantly scale up its existing engagement in those sectors, or forms of aid, which will increasingly drive growth.'

Australia's past approach on growth has been to focus mainly on promoting the environment for growth as part of its governance agenda. While an emphasis on governance will remain important, the analytical reports support what we have called a 'governance-plus' strategy, with greater focus on the 'drivers of growth' such as infrastructure and rural development. This is not to encourage greater state involvement in the private sector. Rather, it is about addressing binding constraints and market failures, such as infrastructure bottlenecks and thin credit markets, with implementation as much as possible through the private sector. We do not underestimate the difficulty of doing this, especially in poor-governance environments. But we do not see an alternative, given the primacy of growth for poverty reduction and the, at best, long-term nature of institutional change.

WHY FUNCTIONING STATES?

The effective functioning of a state's key institutions is central to development. Effective governments provide the environment – through appropriate policies and regulations, property rights and supporting infrastructure – to promote private sector development and hence growth and employment generation. They maintain law and order and stability, provide for the protection and advancement of human rights, and ensure the sustainable use of resources. They generate revenue, deliver education and health services, and redistribute income.

The importance of governance is confirmed as a central focus in each of the analytical reports. Weak capacity and corruption have seen some of the region's governments perform poorly, with deleterious consequences for poverty and stability. In parts of Australia's immediate region, the exercise

of political power is, at times, inconsistent with the notion of broader national interest. At the other end of the spectrum, otherwise well-performing states are grappling with a new set of challenges that face a modern nation-state – for instance, pandemics, international trade regimes, microeconomic reform, economic integration and environmental protection.

WHY INVEST IN PEOPLE?

Investing in people is the building of human capital through providing better access to quality education and health services. It also encompasses the promotion of equal opportunity. Working towards gender equality is particularly important since AusAID's programs are often in countries with severe gender discrimination. Strengthening human capital provides the poor and others with the opportunity to participate in the economy and find employment and income-generating opportunities. A healthy and educated workforce is more productive and enables economies to be competitive. A society with gender equality is both more equitable and more efficient than one without – for example, literate and numerate mothers normally experience lower infant mortality, have fewer children, raise healthier and better-educated children, and have children who become more involved in democratic processes. An informed citizenry is more likely to hold accountable those in political and bureaucratic power, and access to services forms an important part of establishing the legitimacy of state institutions.

The performance of the core institutions of the state, particularly budgeting and financial management and the provision of a safe environment for the delivery of services, are important for improving social indicators. So too is economic growth – it provides the resources and incentives for investments in health and education. But investing in people is also important for growth, as the latest World Development Report argues (Box 4.1).

Within Australia's immediate region there are a number of areas – such as women and children's health, domestic violence, HIV/AIDS, malaria and poor quality education – where progress is either slow or negative and where the need for action is particularly compelling.

BOX 4.1 EQUITY AND DEVELOPMENT: THE 2006 WORLD DEVELOPMENT REPORT

The latest World Development Report (WDR) reconsiders the long-standing issue of the relationship between equity and development. It defines equity as equality of opportunity and argues that equity, thus defined, will not only directly benefit the poor, but also promote growth prospects. 'By ensuring that institutions enforce personal, political, and property rights for all, including those currently excluded, countries will be able to draw on much larger pools of investors and innovators, and be much more effective in providing services to all their citizens. Greater equity can, over the long term, underpin faster growth.' Thus, while the 2006 WDR promotes equity, it is not anti-growth. Rather, in large part, it promotes equity to promote growth.

The WDR's recommendations – for state interventions in early childhood development, education, public health and safety nets, and for the broadening and deepening of basic state institutions to serve all citizens – are very much consistent with our emphasis on investing in people and supporting functioning states. The final sentence of the WDR Overview highlights the similarity between its approach and ours: 'Faster growth and human development in poorer countries are essential to reducing global inequity and to reaching the Millennium Development Goals.'

WHY REGIONAL STABILITY AND COOPERATION?

Stability is perhaps the most important pre-determinant for growth and poverty reduction. New challenges to stability are emerging, most notably transboundary threats such as pandemics, transnational crime, illicit drug and people trafficking and terrorism. These are not only direct threats to development, they also deter investment and diminish legitimate and stable employment prospects. While ensuring stability is a core function of an effective government, the nature of transboundary threats is such that they can only be managed effectively through regional networks

and cooperation. Traditional hierarchical national responses will not be effective.⁵⁹

At the same time, enormous opportunities exist to enhance growth and streamline the costs of government through greater regional integration and approaches. In Asia and the Pacific the next ten years are likely to see significant opportunities to boost trade and growth, and to pool resources for governance through regional cooperation.

4.C CONCLUSION

Though no doubt one could argue about the exact wording and structure, we are confident that these four themes address the core areas that Australia's aid program should focus on. In particular, these themes place the right emphasis on growth within the aid program by according it a very important but not exclusive priority.

Some have put forward the suggestion that the MDGs should be used as a 'framework for program planning' for the aid program.⁶⁰ This does not seem to us particularly helpful. Australia's commitment to the MDGs is captured, we have argued, by the definition of the aid program's overarching objective in terms of poverty reduction. What we have proposed in this chapter is a strategic framework for maximising Australia's contribution to global poverty reduction or, equivalently, achieving the MDGs. As the recent DAC review of AusAID noted, 'the MDGs can serve as a useful vehicle to convey a sense of the work to be done, while not being offered as a guide to programming.'⁶¹

Related to this, a number of calls have been made by groups for Australia to provide a certain amount of aid funding in pursuit of a certain MDG (e.g. water). This kind of recommendation is based on an assumption that providing funds directly for water projects is the best way to achieve the MDGs relating to access to water. In fact, achievement of any one MDG requires action on a range of fronts. For instance, security and law and order are critical

pre-requisites for achieving health and education goals in a country like Solomon Islands. In other countries, improvements in basic public expenditure management will have a large impact on health and education goals. More broadly, efforts to stimulate growth will not only directly reduce poverty, but also generate revenue for governments to spend on services such as water.

Finally, we note the criticisms in the DAC review of AusAID that there is 'a lack of clarity on the hierarchy of principles and values guiding the Australian aid program. Poverty reduction receives lower prominence in Australian programming than AusAID's policy statements would suggest.' We are not sure to what extent these comments are valid. But, to the extent they are, we hope that the strategic framework put forward in this chapter will remedy the situation. Individual country strategies should not have to make the case for how fostering functioning states, accelerating economic growth, investing in people and promoting regional stability and cooperation will lead to poverty reduction. That can be taken as a given. Rather, country strategies should focus on how, given country circumstances, each of these objectives will be weighted and approached. Some more concrete suggestions and options to pursue in this regard are discussed in the next chapter.

Recommendation 4.1 *Adopt the themes of accelerating economic growth, functioning and effective states, investing in people, and promoting regional stability and cooperation as the **strategic framework** for the Australian aid program, and prepare regional and country strategies and other interventions within this framework.*

Recommendation 4.2 *Assist in regional and/or national efforts to report progress against the **Millennium Development Goals**.*

59 Professor Michael Wesley – contribution to proceedings at the Transboundary Issues Roundtable meeting on 29 August 2005, at the Queensland University of Technology, part of the White Paper consultation process.

60 ACFID (2005)

61 OECD (2005a, p. 25)

5 Thematic Programs and Initiatives

We outlined in the previous chapter the four themes we recommend for Australia's aid program: economic growth, functioning states, investing in people, and regional stability and cooperation.

These are vast themes, especially in relation to the size of the aid program which is less than one dollar per person per year in the Asia-Pacific region.

The Australian aid program needs more specific strategies and initiatives to maximise its contribution. These are set out below. We outline the kinds of indicators that could be used to judge success in each of the four areas at the end of the chapter.

5.A ECONOMIC GROWTH

There can be no task more important for the aid program than supporting growth. As was argued in Chapter 3, without growth sustainable poverty reduction cannot be achieved. In particular, the aid program should pursue broad-based and labour-intensive growth, since that will be of the greatest benefit for the poor. Growth will predominantly come from the private sector. The role of the public sector should be to facilitate growth rather than produce growth itself. Based on international experience, as well as the research commissioned for the White Paper, we propose a mix of longer-term institutional initiatives and shorter-term growth-oriented assistance. We are of

the view that the growth agenda cannot be reduced to one of improving institutional quality. Not only will institutional reforms take a long time to deliver, but also we have seen in country after country that growth itself can become a powerful force for governance reforms, leading to a virtuous circle. We propose therefore a 'governance-plus' agenda for growth, with three focus areas: (i) improving the policy environment for growth; (ii) supporting the drivers of growth; and (iii) sustaining growth in the face of environmental challenges.

IMPROVING THE POLICY ENVIRONMENT FOR GROWTH

The regulatory environment set by government is critical in determining a country's growth prospects. Openness to trade, promoting competition, and cutting red tape are all important objectives for governments. AusAID is already involved in providing assistance in most of these areas. We recommend that this continue, though with the caveats of the next section concerning technical assistance.

Facilitating trade is a crucial role for government. Countries in the region stand to gain significant benefits from trade negotiations but are often unable to analyse opportunities and fully comprehend the implications of different negotiating positions. AusAID has already been active in providing trade policy and analysis training for many countries in the region and this should continue. Enhancing

trade facilitation is also important and another area of existing AusAID engagement. Strengthening customs and quarantine arrangements can enhance competitiveness while also maintaining the integrity of national borders.

Growth strategies: We recommend that AusAID provide assistance, perhaps in collaboration with other donors, to interested governments to help them develop sectoral, regional or national growth strategies. This is not a call for central planning. But governments need to have a sense of where growth will come from in their economy, and then of what they can realistically do to promote this growth. For example, in the Pacific, it is clear that growth will not come from the production of mass commodities, in which the Pacific will never be competitive. It is more likely to come from the development of niche products for which Pacific producers can command premium prices to compensate them for their natural disadvantages, such as high transport costs. How governments structure their policies and expenditures towards this end (e.g. what sort of infrastructure) will depend upon the niches in which they see their economy being competitive. The development of realistic and budgeted growth strategies will therefore assist a country's growth prospects.

Strengthening property rights is fundamental to improving development prospects, though experience shows that there are a number of ways in which this can be done. AusAID has had considerable success in this area in Asia through land-titling programs, but less so in the Pacific, where the issues are both more pressing and more controversial on account of widespread customary land ownership. There is, however, an emerging consensus that a 'middle way' has to be found that essentially combines customary ownership with long-term leases that can be used as collateral for accessing commercial credit. The Pacific analytical report recommends this path and also makes three other important comments about the issue: first, that any changes to land-tenure will have to come from within the Pacific; second, that they will take

considerable time; and third, that provision of infrastructure and trade liberalisation will likely lead to pressures for secure land tenure.

We believe that the issue of land tenure, while complex and long-term in nature, cannot be avoided. We suggest that a Pacific Land Mobilisation Program be launched, preferably in conjunction with interested regional agencies and individual governments. The aim of the program would be twofold: (i) to survey and disseminate innovative land mobilisation practices in the Pacific; and (ii) where there is clear demand for it, to resource innovations and improvements in land tenure arrangements.

In a similar vein, it would be useful for the Australian aid program to investigate how property rights can be strengthened with respect to fisheries, forests and other natural resources in the Asia-Pacific region.

Recommendation 5.1 *Assist partner governments to improve the policy environment for growth by:*

- (a) reforming regulatory policies and facilitating trade*
- (b) helping key partner countries develop growth strategies*
- (c) developing a Pacific Land Mobilisation Program to survey and support improvements in land tenure systems, in collaboration with regional agencies and interested governments.*

SUPPORTING THE DRIVERS OF GROWTH

Infrastructure – funding and ideas: Ensuring adequate infrastructure is one of the basic responsibilities of any government and a critical part of the enabling environment for private investment. There is increased awareness worldwide of the importance of infrastructure for growth, poverty reduction and achievement of the MDGs, including gender equality.⁶² In Asia, rapid growth and urbanisation (section 2.B) are threatened by infrastructure bottlenecks. If the Australian aid program is not addressing infrastructure, it is not addressing the main constraint to growth in Asia. In the Pacific, infrastructure inadequacy is one of a

62 Targeted investments in time-saving infrastructure (water, fuel, transport and telecommunications) have benefits for women and promote gender equality (Jütting and Morrison 2005).

number of factors leading to economic stagnation. Infrastructure has been a declining sector for AusAID in both absolute and real terms, though the recent AIPRD engagement in Indonesia has led to a new emphasis on infrastructure in that country. Funding needs for infrastructure in the Asia region are huge (estimated at US\$200 billion annually over the next five years in East Asia alone),⁶³ but getting the policies right is as important as increasing funding. Australia has considerable expertise in infrastructure reform and regulation and should make that expertise available to the region. We recommend that Australia consider supporting the Public-Private Infrastructure Advisory Facility,⁶⁴ and encourage the facility to become more active in Asia and the Pacific and to avail itself of Australian expertise.

Infrastructure projects can not only have high returns, but can also be important vehicles for policy reforms. However, outside of the core countries of the Pacific and Indonesia, this is an activity best approached through partnerships with the larger, more experienced development banks or International Finance Institutions (IFIs). In the Pacific, the challenge is to leverage the participation of the IFIs through co-financing and blending arrangements. In Asia, AusAID needs to enter into discussion with the IFIs at regional and bilateral levels about how best to collaborate to combine the provision of investment funding and technical assistance in core assistance countries. One possibility would be to discuss the creation of an Australian Asia Infrastructure Fund with the IFIs. This fund, which would operate through the IFIs to maximise impact by leveraging off their interventions, could be designed to promote particular infrastructure-related objectives of concern to Australia. These might include regional integration, infrastructure investment policy, or improved transparency and anti-corruption – the infrastructure sector is usually one of the most prone to corruption given the large funds involved. By

aligning with the major infrastructure donors, the fund could also help promote common approaches and harmonisation.

Infrastructure frequently poses problems of sustainability, particularly with regards to maintenance. Ensuring that adequate mechanisms are in place for cost-recovery and maintenance should be an integral part of project preparation. If maintenance is greatly under-funded, there is no point building new assets.

Recommendation 5.2 *Expand support for infrastructure through the provision of ideas and funding, in collaboration with other aid agencies, in particular the development banks, including through:*

- (a) *exploring the feasibility of an Australian Asia Infrastructure Fund to be operated in partnership with the World Bank and/or the Asian Development Bank*
- (b) *participation in the Public-Private Infrastructure Advisory Facility*
- (c) *giving priority to adequate funding for maintenance.*

Building competitive workforces: While better and broader education at all levels will contribute to higher average incomes, there is a particular need in the Pacific to give more focus to skilled training at the post-secondary and vocational level. While it will be essential to ensure that within-country skill shortages are addressed,⁶⁵ it would be a mistake to think of improving labour market opportunities for Pacific Islanders only in domestic terms. Increasingly, Pacific Islanders should be competing in the international labour market. A recent ADB-Commonwealth review shows that for every dollar spent on training Islanders to become nurses to work overseas, a return of \$6 would be forthcoming.⁶⁶ This return would not only flow to the migrating individual, but also benefit the community through remittances and improved stability. This form of training is particularly important for the Melanesian countries of Vanuatu,

63 Asian Development Bank et al. (2005)

64 PPIAF is a multi-donor sponsored facility, originally established as a joint initiative of the United Kingdom and Japanese Governments working closely with the World Bank, which promotes public-private partnerships in infrastructure.

65 A recent ADB publication (2003) notes that, 'Most Pacific economies are critically short of skills of all types.' (p. 163)

66 Duncan (2005)

Solomon Islands and PNG which, unlike their Polynesian counterparts, have not had access to international labour markets and which, as a consequence, have had a much harder time dealing with problems of unemployment and resultant social instability. Providing migration opportunities is also important for the tiny Micronesian and Polynesian countries, whose economies are unlikely to be viable without migration, as well as for Fiji which is facing a traumatic economic adjustment due to the likely rapid decline of its sugar and textile exports. We therefore recommend that for these countries vocational and post-secondary training be given much greater emphasis and resources, with a particular focus on providing 'skills for migration'. Further discussion on labour mobility and migration issues for PNG and the Pacific is contained in Chapter 7.

Such an initiative would be best approached regionally, that is, through the establishment of regional training institutions. This is in line with the Prime Minister's recent announcement at the Pacific Islands Forum, which we strongly support.⁶⁷ We also suggest that private sector involvement in this initiative be provided for, in particular to ensure that accreditation arrangements maximise migration opportunities. Finally, we note that the issue of cost-recovery requires further investigation. Pacific Islanders are already struggling to meet their basic education requirements. Cost-recovery should be attempted, perhaps through arrangements of the sort in place in the tertiary sector in Australia (i.e. the Higher Education Contribution Scheme). However, a pragmatic approach will be required, and long-term external funding (as is provided to the University of the South Pacific) will be required to make this worthwhile initiative succeed.

Recommendation 5.3 *Use the aid program to provide skills training to build more competitive workforces in the Pacific Islands, both for domestic labour markets and to promote labour mobility.*

Supporting rural development: Rural development

and agricultural growth will continue to be critical drivers of poverty reduction over the next decade in most developing countries. Growth in agricultural productivity increases farm incomes, stimulates development of the non-farm economy and generates employment in rural areas, where the majority of the poor live. Research by the World Bank and others, undertaken on China, Indonesia and India, has shown agricultural growth to be much more effective in reducing poverty than industrial growth.⁶⁸ For the land-rich Melanesian countries, which have most of their population in the rural sector, sustained economic growth will have to be on the back of productivity growth in the rural sector. Only in this way will the necessary income and savings be generated to fuel growth in other sectors.

Spending on rural development is only a small part of Australia's aid program. It has remained at around \$200 million (2004 prices) since 1996-97 and declined in relative terms from 12 per cent to 9 per cent of total aid funding. A major expansion of AusAID's rural development program is warranted in order to raise the productivity and incomes of those deriving their livelihoods in the rural sector.

A number of factors have recently transformed the environment in which farmers operate, including trade liberalisation, the integration of global value chains, the growing importance of food quality standards, lower real prices for staples and the changing role of the state. Increasing scarcity of natural resources such as forestry, fisheries and land; the overuse of chemical inputs that are environmentally unsustainable; and the potential impacts of global climate change compound these challenges.

The major rural development focus for the aid program should be to help governments facilitate growth in agriculture, forestry and fisheries while maintaining the natural resource base. Activities should focus on the production of 'public goods' such as the establishment and administration of legal and regulatory frameworks that promote economic activity, including for land (discussed

67 The Prime Minister announced the 'establishment of an Australian Technical College for the Pacific to promote more competitive workforces and enable greater labour mobility between the Pacific and developed economies such as Australia'. See http://www.pm.gov.au/news/media_Releases/media_Release1657.html.

68 For a discussion of research findings on this issue, see World Bank (2005c) and Timmer (2005).

above); the provision of infrastructure; research and development; and protection against animal-borne diseases. Much greater emphasis than in the past will need to be given to public–private partnerships, trade and market development, and technical support for smallholders and commercial producers. Rural development should clearly be an area of close collaboration between AusAID and ACIAR.

Business development and financial services for small enterprises: AusAID already supports various non-government regional facilities that provide training and capacity building for the small and medium enterprise sector, such as the International Finance Corporation’s (IFC) South Pacific Project Facility. Microfinance is one enterprise development intervention that has been shown to be very successful in Asia, including in some AusAID projects, for example in Vietnam. Microfinance for women has been found to be particularly effective, resulting in better repayment rates, and social benefits including increased household income and investment of profits in children and health care.⁶⁹ Such interventions should be designed to address market failures without introducing government failure. As much as possible therefore, they should be approached in partnership with the private (or non-government) sector rather than through government channels (a theme we develop in Chapter 6). Importantly, microfinance should be seen as only one input into enterprise development. AusAID should look into the feasibility of a more comprehensive approach to supporting small and medium scale enterprises. In conjunction with relevant partners like the IFC, such approaches would involve training and support in finance services and developing entrepreneurial skills and outlook. One way to do this, which has been proposed and which warrants consideration, would be through establishment of a regional fund.

Recommendation 5.4 *Increase the emphasis of the aid program on rural development and on support for small and medium enterprises. Consider the feasibility of a small and medium enterprise development program for the Asia–Pacific region.*

HELPING TO SUSTAIN GROWTH

As discussed in Chapter 2, Australia’s development partners face major environmental challenges, which will only increase in the coming years. In the Asia–Pacific region, industrial, urban, mining and air pollution; water shortages; and land degradation are all important issues. China has 16 of the world’s 20 most polluted cities.⁷⁰ India, the other Asian giant, is facing a water crisis of unprecedented proportions.⁷¹ Most Pacific island countries face increasing environmental problems due to their rapidly growing populations and resulting rapid urbanisation. Their problems take the form of land degradation, pollution of fresh water sources and inshore fisheries, degradation of coral reefs, loss of forests and biodiversity loss. The Pacific island countries are also threatened by the effects of climate change, including more frequent and severe weather events and sea-level rises. While popular perception focuses on risks arising from sea-level rises, in fact more immediate and pressing threats will likely arise from an increased frequency of cyclones.

AusAID’s approach to date has been largely to try to mainstream environmental considerations within activity designs (that is, to consider environmental issues in all aspects of design where relevant), based on the *Environmental Management Guide for Australia’s Aid Program*. The question arises as to whether a much greater global and regional focus on the environment as well as a much expanded aid budget, warrant greater agency focus on the environment and more broadly, on sustainable development. Given the mounting environmental challenges facing the Asia–Pacific region, we think it does. But this engagement needs to be targeted and strategic if it is to be effective. With this in mind, we recommend that AusAID develop its

69 Coleman (2005)

70 Asia analytical report (p. 8)

71 World Bank (2005f)

analytical capacity on environmental issues and that this process should lead in the first place to a new environmental strategy for the aid program. While we are not in a position to pre-empt the findings of this strategic exercise, it would clearly need to consider the relative priority to be given to natural resource management and energy issues, and the relative merits of multilateral and bilateral approaches in this area. The background document prepared for this report (Centre for International Economics 2005) on environmental issues should provide a very useful starting point.

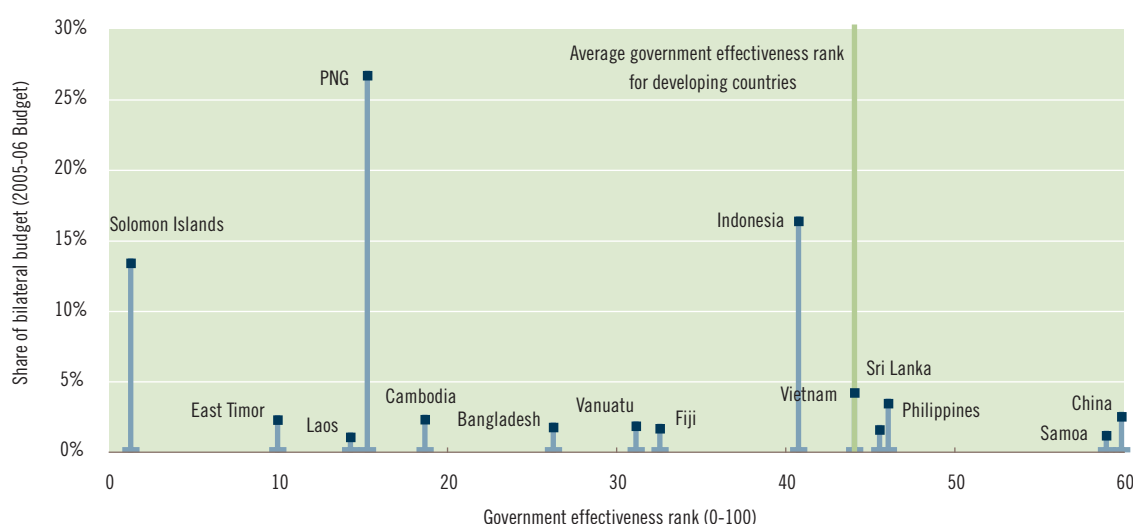
Recommendation 5.5 *Develop an environment strategy to guide an expanded but strategic engagement on issues around sustainable development.*

5.B FUNCTIONING AND EFFECTIVE STATES

As we noted in Chapter 2, governance has been given increasing emphasis within the aid program.⁷² This is in line with international thinking which, as outlined in Chapter 3, has come to stress the

over-riding importance of domestic policies and institutions for growth. This understanding is particularly important for most of Australia's main development partners, which suffer from weak institutions and poor governance. In the 2005-06 budget, Australia has 14 major bilateral aid recipients (budgeted to receive ODA of \$20 million or more) who will receive \$1,480 million, or 80 per cent of the total bilateral aid budget.⁷³ Figure 5.1 below shows on the horizontal axis where each of these major recipients sits in relation to a World Bank ranking of 'government effectiveness', derived from a survey of 209 countries (with a lower rank indicating a worse position). The vertical axis shows each country's share (%) of the total bilateral aid budget. As can be seen from the graph, PNG, Laos, East Timor and Solomon Islands account for more than 40 per cent of Australia's bilateral aid (PNG and Solomon Islands together account for more than one-third of the total), yet these four countries have a government effectiveness rank of 15 or below. Of the 14 major recipients, nine (including Indonesia) have government effectiveness rankings below 44

FIGURE 5.1 SHARE OF AUSTRALIA'S BILATERAL AID BUDGET AMONG MAJOR RECIPIENTS



Source: The government effectiveness ranking is from the World Bank Institute Governance Indicators for 2004. The authors note that their point estimates are subject to a margin of error, and that cross-country comparisons should be made with caution. See: <http://www.worldbank.org/wbi/governance/pubs/govmatters4.html>
 Note: The shares are the bilateral aid budgets for the various countries divided by the total bilateral aid budget for the 14 major recipients (with budgeted ODA allocations of \$20 million or more).

72 Better Aid for a Better Future (Downer 1997) which was the Government's response to the Simons Review, committed to 'make governance a specific focus for Australia's aid program for the first time.' The other four priority sectors were health, education, agriculture and rural development, and infrastructure.

73 For the purposes of this comparison and that in Figure 5.1, 'bilateral aid budget' refers to total Official Development Assistance (ODA) that is attributable to specific countries or regions.

– the average rank across the developing countries surveyed. So the great bulk of Australian assistance is going to countries with below average government effectiveness.

The World Bank's Country Policy and Institutional Assessment (CPIA) tells a similar story. In 2004, the Bank assigned a CPIA score for ten of AusAID's 14 major recipients. Only one (Samoa) is in the top fifth; five are in the bottom two-fifths (Cambodia, PNG, Vanuatu, Laos and Solomon Islands). Countries that fall into the bottom two fifths are often defined as 'fragile states', meaning that they have great difficulty in fulfilling the basic functions required of a state, including law and order in some cases (see Chapter 3). Australia's bilateral aid program is concentrated in these fragile countries. Unless their governments become more legitimate, accountable and effective, they will not see sustained development gains.

While no-one can argue with the goal of improving governance and building capacity, finding the best means to pursue these aims is a continuing challenge. Australia has largely relied on technical assistance to help partner governments develop better and more transparent policies and institutions. Yet, as we saw in Chapter 3, a series of reviews have argued against over-reliance on this approach, particularly in fragile states where such efforts have achieved some gains but certainly not to the extent desired.

Recently, the Australian Government has turned to the direct provision of technical assistance through Australian civil servants drawn from relevant Commonwealth departments, such as the Treasury and Australian Federal Police. Many view this as more effective, perhaps because the staff members come with more implicit backing from the Australian Government, and thus authority. Further, this model builds long-term institutional links between the Australian sending agency and its counterparts in the region. However, there are intrinsic limits to this approach (e.g. limits on the capacity of the departments to provide suitable staff and on the willingness of partner governments to receive them).

It should also not be assumed automatically that government staff will perform more effectively than their counterparts in the private or non-government sector, especially with regard to the specific skills required to be an effective adviser or trainer.

We have four main recommendations for how the aid program can build most effectively on recent initiatives and pursue better governance.

First, improving policy and institutional quality should be the focus of the entire aid program, not of one set of 'governance' interventions. This recommendation has three implications, all of which add up to the argument that one should judge a program's focus on institutional quality not by how much is spent on governance but by the overall country strategy.

- a) Interventions in a particular sector should aim to improve policies and institutions in that sector, either through pilots or across-the-board. The value of aid should not simply be to transfer resources, but also to innovate and so to reinforce good, or demonstrate better, ways of doing business.
- b) It might often be the case that the best way to improve governance is indirectly, for example, by promoting education or extending infrastructure. A better educated population will be able to make better informed electoral decisions. And, as poor countries grow and their middle classes develop, societies start to demand more of their governments. Of course, expanding access to education and extending infrastructure are not in themselves easy to do in poor-governance environments, but it cannot be pre-judged whether a direct or indirect approach to governance is preferable.⁷⁴
- c) Care should be taken that the aid program does not undermine institutional quality. Increasingly, it is argued that aid can actually damage domestic institutions. It can bail out bad governments, suck out their most talented staff and reduce accountability to the local population. These are real risks in some contexts and they should be

⁷⁴ It is interesting in this context to note that, though the Simons Review urged a greater focus on governance, it did not itself call for a large increase in technical assistance. In the context of PNG and the Pacific, the review noted that, 'The greatest long-term assistance to good governance and capacity building will come through persisting with efforts to improve primary and secondary education and so create a constituency for better governance.' (Simons et al., 1997, p. 107)

addressed seriously through individual country strategies. In general, the best way to combat these risks is to work in close partnership with other development actors – partner governments, civil society and other aid agencies – a subject we return to in the next chapter.

Recommendation 5.6 Helping states function more effectively *should be an overall focus of the aid program and of country strategies, rather than the mandate of a sub-set of governance activities.*

Second, while maintaining a strong engagement on economic governance and law and order, the aid program should also focus in weaker-performing countries on political governance. Poorly performing states suffer not only from limited policy- or budget-making capacity, but also from poor political performance. As one commentator has remarked, ‘the first challenge of economic development is political – building institutions that make leadership accountable to citizens.’⁷⁵ The strong emphasis of the aid program on economic and bureaucratic aspects of governance needs to continue, as the various background papers all suggested. But at least in the weaker-performing states and where the aid program is significant enough for this to be a realistic goal, a much bigger emphasis is warranted on what might be termed ‘political governance’, that is, how to provide assistance to the political leadership of partner countries to become more pro-development. Bilateral grant-giving agencies can still run into sensitivity issues but have greater flexibility to deal with the more political end of governance than multilateral agencies do. Increasing the emphasis on political governance is likely to require action on various fronts:

a) A whole-of-government approach with strong political leadership should be sought where a role for Australia is identified. Political governance is a key concern for the foreign affairs portfolio, and aid program involvement should

reinforce and complement broader Australian engagement and thinking. This should include supporting the growing engagement between parliamentarians and political parties in Australia with their counterparts in our key partner countries.⁷⁶ Depending on country circumstances, partnerships with other influential players should be pursued.

- b) Political and social change is a long-term process, measured over decades rather than years. It can only come from within and requires sustained and broad leadership. In addition to assisting the development of the current leadership, the aid program can also contribute to a deeper leadership pool for the future through the provision of scholarships (see the more detailed discussion in section 5.C).
- c) The aid program should aim to reward performance so as to provide greater incentives for better performance. We return to this suggestion in the next chapter as a general theme, but one example particularly relevant here is the provision of support to sub-national governments on a performance basis. AusAID is trialling this in PNG and the experience should be closely monitored and reviewed. Worldwide, there is a trend in developing countries towards decentralisation. Whether this is for better or for worse, it means that sub-national governments are becoming increasingly important. This shift provides the Australian aid program an opportunity to choose among sub-national governments and throw its support behind the better performing ones, thus ensuring not only better utilisation of funds but, it is hoped, the introduction of healthy competition among peers.
- d) There should be more emphasis on strengthening non-state actors. Domestic demand for reform and accountability is a key driver for better state performance.⁷⁷ There have been interesting innovations supported by Australia’s

⁷⁵ Root (1999)

⁷⁶ A key vehicle for this engagement is the aid program funded Centre for Democratic Institutions (CDI). CDI’s goal is to strengthen the performance of parliaments and political parties particularly in Indonesia, East Timor, PNG, Solomon Islands, Vanuatu and Fiji, through technical assistance, capacity building, networking, and interpersonal and knowledge exchange.

⁷⁷ The commentator Francis Fukuyama (2004) recently observed that, ‘Insufficient domestic demand for institutions or institutional reform is the single most important obstacle to institutional development in poor countries.’

aid program through media, civil society and civic education programs (e.g. the PNG Church Partnership program and War Against Corruption campaigns, support for national human rights institutions, and partnerships with Transparency International). We recommend a major expansion, both through direct support to the relevant organisations in partner countries and through Australian organisations (from development NGOs through to business councils and universities). Encouraging women's groups to mobilise and demand better services and accountability can be an important aspect of strengthening demand for good governance. Building capacity in developing countries for independent analysis of government policy is also important.

- e) Nation building is a legitimate part of the aid program, since without a sense of nation the accountability of politicians falls and the likelihood of civil unrest increases. Support for sporting competitions and media productions can help our younger neighbours strengthen their sense of national identity.
- f) Since political governance is a new area for the aid program to tackle, there should be a research emphasis on better understanding political governance, voter behaviour, the incentives that guide the region's politicians and how to align these incentives better with national developmental goals. For instance, most PNG politicians have only served one consecutive term in office – understanding why the electoral system or voter behaviour produces such an outcome may provide some useful insights. Box 5.1 provides a summary of a recent global research project on the political economy of reform. While the project threw up a number of interesting insights, it also demonstrated that there is still a lot to learn on the political economy of reform and government performance.

As is evident from the above list of areas for possible action, while a focus on political governance might sound intrusive and unfriendly, it could in fact involve a number of positive interventions such as

BOX 5.1 UNDERSTANDING REFORM

'Understanding Reform' was the theme of the second of the Global Development Network's Global Research Projects. The goal of the project was to understand the successes and failures of various reforms through a cross-country comparison of reform policies and experiences in different regions. Major project findings are summarised below.

There are no blueprints for reform. Outcomes depend on the idiosyncratic nature of countries – the context, initial conditions and sequencing of change in which the reforms take place. The reform process is as much about institutional change as it is about policy change. Reform implementation is a key feature of a reform's success, and implementation success is determined by the political economy of reform – the winners and losers from any action. Since political stakes are often higher in the short-term, reforms that produce poor results (such as lower employment) in the short-term may reduce support for future reforms. 'Clientelistic' governments, which base their power on satisfying narrow interest groups, face particular problems in implementing reforms – they are dependent on support by small groups who benefit from the status quo, and consequently reforms are delayed even though current policies are obviously not working.

There is a need for a better mapping, from institutions to policy. Reformers and donors tend to take for granted the existence of an effective state, endowed with an efficient bureaucracy. Often recommendations for changes to institutions are made in terms of current best practice, without regard for the capacity of the institutions to take on these practices. Since reforms lead to institutional change, factors that foster or impede institutional change and institution building need to be determined. Economic assessments for reform should be complemented by a study of factors relating to the political economy and institutional capabilities of a country.

Source: Fanelli and McMahon (2005)

working with the broader society, the provision of scholarships, and rewards for performance.

Recommendation 5.7 *In weaker-performing countries, focus the aid program on **political governance** as well as the rule of law and economic and bureaucratic governance. This will require:*

- (a) *a more integrated cross-government approach*
- (b) *recognising the long timeframes involved, more emphasis on strengthening future leaders*
- (c) *making greater use of incentives in the aid program*
- (d) *providing more support to non-state actors.*

Third, we recommend that more selective and effective use be made of technical assistance. The Australian aid program puts heavy emphasis on technical assistance (TA). About 47 per cent of the existing aid program is classified in this way. This is among the highest of OECD donors, compared with 10 per cent for the United Kingdom's aid agency, for example.⁷⁸ There will still be a need for technical assistance but given the mixed track record, and consistent with recent global thinking on the subject, a more selective approach is recommended. Especially in fragile contexts, technical assistance should be used in the context of the long-term approach to change advocated earlier. It should be guided by the following considerations:

- a) TA arrangements should be explicit about objectives, including whether the assignment is to *provide* or *build* capacity. Both can be appropriate, and in fragile environments there might well be occasions when the long-term provision of administrative and in-line capacities is required (capacity substitution). Where Australia is providing capacity substitution, capacity building should still be pursued, even if it as a long-term goal (e.g. the recruitment and training of new staff).
- b) TA should normally be provided in response to a clear and realistic demand from politically committed government partners, where the institutional barriers to change have been clearly

identified and where the technical skills requested are consistent with local requirements. The aim should be to support 'good enough' not 'best practice' governance.

- c) In less conducive environments, technical assistance can have a legitimate role in maintaining a footprint and keeping a dialogue with partner government agencies that would provide for a smoother scaling-up of assistance if conditions become more favourable.⁷⁹ The objectives, expectations and resourcing of such assistance should be calibrated accordingly.
- d) The individuals deployed should be accountable primarily to the government department that requested the input in the first place (and therefore the government itself should have the last say in the selection of the relevant individual(s)).
- e) In many cases, it will be more appropriate to focus TA on helping governments implement more effectively, rather than plan more professionally. For many developing countries, the binding weakness is implementation rather than planning and TA will often be better spent helping implementation. Too often TA is wasted on producing detailed plans that cannot be implemented.
- f) The approach to TA should be opportunistic. Since effective governance reform is characterised by 'strategic incrementalism' (that is, the ability to identify particular opportunities to build on progress), TA will often need to be deployed in large amounts at short notice. Thus flexible arrangements are needed, such as the Technical Assistance Management Facility in Indonesia. Equally, in the absence of progress major TA efforts should be terminated to prevent further waste of resources. RAMSI and ECP are good examples of opportunistic interventions but they are also large and expensive and so need credible transition strategies.

78 DAC (2005)

79 The RAMSI intervention in Solomon Islands, and ECP in PNG, were built on the footprint provided by the existing technical assistance program, which is seen to have played a key role in the implementation of these initiatives.

Recommendation 5.8 *Make more selective and effective use of technical assistance (TA). This will require:*

- (a) being more explicit about objectives*
- (b) using TA predominantly where there is clear demand for it and an opportunity to make progress in critical reform areas*
- (c) in non-reform environments, calibrating resources, expectations and objectives towards building relationships and maintaining a dialogue with key partner government agencies*
- (d) increasing the accountability of TA providers to their counterpart governments*
- (e) shifting the focus of TA away from planning, and towards implementation and monitoring.*

Fourth, continued priority will need to be given to ensuring security but greater attention should be given to conflict prevention, nation building and emergency management. Countries throughout the Asia-Pacific region are susceptible to conflict and security crises. The ensuing instability not only takes lives and erodes hard-won development gains but also undermines growth prospects and derails broader development activities. Such deterioration is neither linear, nor constant.

The biggest increase in governance spending has been in legal and judicial development, which increased from \$6 million in 1996-97 to \$270 million in 2004-05. This increase largely reflects the cost of restoring and maintaining law and order operations in Solomon Islands and PNG. While there can be no development without law and order, intervening once law and order has broken down is incredibly expensive, as can be seen from the above figures. Greater effort should be given to conflict monitoring and avoidance efforts. In this regard, AusAID has a well developed Peace Conflict and Development Policy.⁸⁰ More recently, AusAID's establishment of a Fragile States Unit is a positive development and could become the core for a whole-of-government engagement with fragile and failed states.

The evolution of fragile states engagement policy (i.e. not to withdraw) also drives aid workers and humanitarian actors into complex security environments. Recent East Timor and Solomon Islands experience underlines the importance of these, often joint, deployments being coherent and highly collaborative. To build on this, AusAID should explore with the Department of Foreign Affairs and Trade (DFAT), the Australian Defence Force (ADF) and Australian Federal Police (AFP) a more formal joint effort to address the peace enforcement, peace keeping, humanitarian, reconstruction and nation building functions necessary to respond to conflict.

Unfortunately, emergency response can be expected to remain high on AusAID's agenda and, indeed, is likely only to grow in importance over time. As noted previously, our region is one of the world's most vulnerable to infectious disease and environmental degradation because of its dense, interconnected and rapidly growing populations, and its particular susceptibility to natural disasters. We recommend an expansion of Australia's humanitarian and response capacity and standby mechanisms at both state and federal levels. Options could include: additional stores of relief and humanitarian items in Australia, the Pacific and South-east Asia; partnerships with Australian NGO and commercial entities and credible UN and international agencies; better coordination between government departments involved in humanitarian and emergency responses; and providing a mechanism for the coherent use of local government capabilities.

80 See AusAID (2004b).

Recommendation 5.9 *Improve emergency responses, conflict prevention and nation building efforts by:*

- (a) ensuring that Australia can, wherever possible, anticipate and respond quickly to emergencies in the Asia–Pacific region, both natural disasters and state/societal breakdowns, by strengthening standby capacities and whole-of-government cooperation*
- (b) developing strategies which draw on private as well as public, and state as well as central government, expertise and resources in such responses*
- (c) strengthening whole-of-government partnerships in post-conflict situations to help, where possible, identify and reduce vulnerability to future instability.*

5.C INVESTING IN PEOPLE

Helping societies achieve better human development outcomes is of both intrinsic value in allowing citizens to live better lives and of instrumental value for achieving higher economic growth and social stability. While Asia is making progress towards meeting the human development MDGs, the Pacific is not, and even in Asia there are no grounds for complacency. As noted in Chapter 2, there are major health threats. HIV/AIDS has already devastated parts of Africa⁸¹ and is now threatening to devastate countries in Asia and, next door to Australia, PNG (Box 2.3). If it does, it will undo all the positive effects of any gains in growth and governance. Most Asia–Pacific countries are making good progress towards universal education, but there are exceptions – in PNG only half of all children complete five years of primary school. Even those Asia–Pacific countries that perform better in terms of access often provide very low quality education compared to OECD standards.⁸²

It would be a mistake to think that human development can be improved only by social sector interventions. Without good law and order, health and education systems will break down. For poor

countries, clean water provided through rural infrastructure projects will do more for health than any number of health interventions. That said, ensuring that health and education spending is of sufficient quantity *and* quality, and that government policies in these areas promote efficient and equitable service delivery, will be critical for ensuring better human development outcomes. Australian ODA spending on education has been held roughly constant at its 1996–97 level of \$280 million (2004 prices). By contrast, spending on health has increased markedly from \$119 million in 1996–97 to \$224 million in 2004–05 (2004 prices). A large part of this increase has been dedicated to HIV/AIDS prevention and education.⁸³

The theme of investing in people goes well beyond human development, in particular to encompass gender equity. A survey carried out in India's most populous state, Uttar Pradesh, found that almost 80 per cent of women in that state require their husband's permission to visit a health centre, and 60 per cent have to seek permission even before stepping outside their house.⁸⁴ Such discriminatory practices are both highly inequitable and highly inefficient, as they grossly under-utilise the productive potential of half the populace.

We argue that there should be a sharp increase in focus in the aid program on investing in people. Such interventions should be grouped under four headings: (i) strengthening national health and education systems; (ii) tackling major diseases – HIV/AIDS, malaria, and pandemics; (iii) supporting higher education through scholarships and linkages; and (iv) addressing gender inequality.

STRENGTHENING NATIONAL HEALTH AND EDUCATION SYSTEMS

Every state has a responsibility to ensure access to universal primary education and to basic health care for all its citizens. Unfortunately, the reality

81 Life expectancy in Botswana, often and rightly held up as a model for other African countries to emulate in terms of economic management, has already fallen from 65 years in 1985–90 to 40 years in 2000–05. By 2010 it is expected to fall to a mere 27 years (US Census Bureau, 2004).

82 Pritchett (2004)

83 The HIV/AIDS component in AusAID's health expenditure has grown from 10 per cent in 1999–00 to approximately 30 per cent in 2004–05.

84 World Bank (2005e)

of poverty and weak governance means that few developing countries do. The main priority of AusAID's human development program should be to work alongside its partner governments to help them improve both the access to and quality of their health and education systems. As we discuss later in the report, it will not be possible to achieve this via small, stand-alone projects, but only through partnering with government and other important service deliverers, such as churches and the private sector. In both the health and education sectors, this will require working with governments to address the difficult issues of sector financing, human resource development, system governance and management. It will also require working with and strengthening private sector and non-government service providers, especially where governments are weak. In health, targeted inputs should focus on prevention and treatment of health problems that cause the greatest burden of disease, and should only promote the use of proven cost-effective interventions. Effectively addressing the health needs of women and children should be a fundamental objective. In education, the focus should be on ensuring universal primary education that results in good literacy and numeracy outcomes, and on secondary education and vocational training, especially in the Pacific, with a view to equipping citizens with the skills they need to work productively. Some technical assistance will be required, but principally AusAID should be engaged in funding improved and expanded modes of service delivery.

Recommendation 5.10 *Devote increased aid resources to delivering sustained improvements in access to and quality of health and school education systems in partner countries. This will include:*

- (a) *focusing health interventions on women and children and on health problems that cause the greatest burden of disease*
- (b) *focusing education interventions on ensuring quality universal primary education that has good literacy and numeracy outcomes, and on secondary education and vocational training.*

TACKLING MAJOR DISEASES

While the most important health intervention to combat major disease threats is to strengthen national health systems, some diseases are of such enormous significance for particular countries that more focused responses are needed. While additional resources will be needed, assistance will also be important, especially to the Pacific Islands, to strengthen their capacity to utilise potential grant funding from the Global Fund to Fight AIDS, Tuberculosis and Malaria.

- a) **HIV/AIDS:** Australia already has a large HIV/AIDS program and leadership role in the region. We broadly endorse the recommendations made in the analytical report on HIV/AIDS. Prevention efforts need to be scaled up in tandem with accelerated efforts to achieve universal treatment access. It is recommended that Australia take a leadership role in ensuring coordination of efforts to expand access to HIV/AIDS treatments for PNG and the Pacific Islands, in line with the goal set at the 2005 UN World Summit of as close as possible to universal access to HIV treatment by 2010. Efforts to increase the domestic leadership commitment in partner countries to combating HIV/AIDS need to be intensified, as this has been shown to be the critical factor in countries that have worked successfully to combat AIDS. Given the disastrous impact of HIV/AIDS in PNG (including a projected reduction of the labour force by 34 per cent by 2020),⁸⁵ an emergency and much larger response to the disease in PNG is urgently required. Efforts to address the gender aspects underlying HIV/AIDS, including domestic violence, need to be integrated into strategies and interventions. Recent efforts to engage the business sector, and strengthen capacity building and research linkages between Australian HIV/AIDS organisations with counterparts in the region, should be intensified.
- b) **Malaria:** Malaria is another huge killer in the Asia-Pacific region. A close neighbour of Australia, Solomon Islands has the dubious distinction of the world's highest incidence of

85 Centre for International Economics (2002)

malaria in spite of attempts to control it dating back to the sixties. Malaria is also the second biggest killer in PNG, after respiratory disease. In addition to the human cost, malaria imposes a considerable economic burden in terms of lost workdays and schooling.⁸⁶ With new technologies, a new global campaign against malaria, and a much-increased aid program to Solomon Islands, now is the time to renew Australia's commitment to containment and rolling back of malaria in the Pacific. We recommend that, in concert with other agencies and regional governments, a new initiative be launched to contain, roll back and ultimately eradicate malaria from the Pacific.

- c) **Influenza pandemics:** If, or when, a pandemic does break out, even if the health impact in Australia could be limited (which can by no means be assured), the economic impact in the region may be devastating, and the demand for humanitarian and development assistance to the region overwhelming. The Government's \$100 million commitment, announced by the Prime Minister at APEC in November this year, to scale up assistance for surveillance, quarantine, and outbreak and infection control in the Asia-Pacific region needs to be carried through as quickly as possible. A continuing strong partnership with the World Health Organization will be particularly important. The demands placed on small developing countries to participate in regional responses to health threats are proving difficult for them to meet because of their limited capacity. Assistance should be provided to help them cope with the conflicting demands of improving domestic health systems and collaborating in regional activities. One way in which this can be achieved is through the development of links between Australian institutions concerned with human and animal health with respect to surveillance, quarantine and research.

Recommendation 5.11 *Scale up our response to the major diseases in our region, with the particular objectives of:*

- (a) *further strengthening Australia's HIV/AIDS response, including the aid program's emergency response to the HIV/AIDS epidemic in PNG and taking the lead in pursuing an international commitment to provide universal HIV treatment in the Pacific and PNG as soon as practical*
- (b) *rolling back malaria in the Pacific*
- (c) *trying to prevent and, if necessary, manage influenza pandemics.*

SUPPORTING HIGHER EDUCATION THROUGH SCHOLARSHIPS AND LINKAGES

The provision of scholarships was one of the first forms of development assistance provided by Australia and has traditionally been a strong part of Australia's aid program. Over time, however, scholarships have become a less important form of aid. In March 1996, there were some 5,600 students studying in Australia on aid-funded scholarships; this had fallen to 2,400 by March 2005.⁸⁷ Correspondingly, the proportion of education spending on scholarships fell from \$127 million in 1997-98 (57 per cent of total aid on education) to \$103 million in 2003-04 (41 per cent of total education spending). Noting the strong endorsement for scholarships in the analytical reports on Asia and Indonesia, there may well be a case for reversing this trend. This has already started to happen. In 2005, Australia announced large increases in scholarships for Pakistan (an additional 500 over five years) and Indonesia (up to an additional 600 postgraduate scholarships will be funded through AIPRD).

Though rigorous assessments of scholarship impacts are limited, the available data and our own experience suggests that they are a useful tool of development, though in some cases (e.g. the

⁸⁶ According to one estimate, malaria reduces economic growth rates in Africa by 1.3 per cent every year (see Gallup and Sachs, 2000). With malaria higher in Solomon Islands than in Africa, one might expect a comparable or higher 'growth penalty' there.

⁸⁷ We note though, there has been an explosion in the number of overseas post-secondary students studying in Australia, up from 12,700 in 1984, to 54,800 in 1994 and to 209,000 in 2004. This reflects the great increase in privately-funded overseas students in Australia. Today, for every post-secondary student studying in Australia on an AusAID scholarship there are about 90 non-scholarship students.

Pacific) their impact is undermined by high rates of out-migration.⁸⁸ In countries such as Indonesia and Vietnam, scholarships have played a very important role in training a top cadre of policy advisers, who on their return have contributed to high national income growth. More generally, it is recognised that scholarships can broaden the leadership pool of countries and help build durable links between Australia and the developing world. Scholarships should not compete with the private education market. Scholarships should be targeted for study in areas of high development priority, and it would make sense to employ the scholarship program to advance issues high on the regional cooperation agenda (for instance epidemiology with respect to pandemics). We also recommend that scholarships should be targeted at individuals who have the potential to become leaders across the political, bureaucratic, scientific, industry and civil society fields. In that sense, and consistent with the recommendation from the Indonesia analytical report, scholarships should be made available to a broader cross-section of candidates to attract potential leaders from the private and non-government as well as public sectors.

While scholarships in Australia should be an important part of the aid program's support for tertiary education and training, they only strengthen developing countries' institutions of higher education indirectly – through, for example, improving the quality of teaching staff. Recognising this, the aid program's Australian Regional Development Scholarship (ARDS) scheme is organised around the principle that if a course is offered by an institution in the Pacific, the scholarship will be awarded there rather than at an Australian institution. Further, since 2003 the ARDS scheme has been offering locally provided distance and flexible learning courses in Fiji and is developing ways to broaden this to other Pacific countries. These efforts could be used to facilitate further local course delivery by Australian institutions in partnership with domestic counterparts. The United Kingdom's Department of International Development (DFID)

has also recently started to pioneer distance learning scholarships and now has 40 per cent of its scholars participating in locally provided distance learning programs.

While not providing students with the experience of learning and living in Australia and the intangible benefits that creates, a distance learning approach has two advantages. First, it is much cheaper than having students study in Australia and so allows many more students to participate for the same budget (from twice to five times as many, according to DFID's analysis). Second, this approach builds on links between host and recipient country tertiary institutions and thus, is more likely to have flow-on effects that will benefit an even larger number of students. A disadvantage is that students may not actually experience living overseas, but with the huge numbers from some countries now studying in Australia as private students, this may not always be a heavy price to pay. We recommend AusAID scale up its use of new forms of recipient-country-based scholarships, such as distance learning and other forms of partnerships, with the aim of achieving cost-effectiveness and building institution-to-institution links.

It is also often said that inadequate links are maintained with scholarship students after they return home. Since the great majority of students in Australia are now non-scholarship students, any alumni arrangements for scholarship students should complement and build on those of Australian universities more generally.

Recommendation 5.12 *Expand scholarships, especially to Asia, with a particular focus on:*

- (a) *ensuring they target studies of high priority and potential leaders from the private, non-government and public sectors*
- (b) *supporting locally provided courses offered by Australian institutions, to promote greater cost-effectiveness and institutional strengthening*
- (c) *supporting alumni associations to maintain links with former Australian students.*

⁸⁸ Although the resulting remittances are an important source of financing for the Pacific Islands, the recently announced skills-training initiative would be a more effective means of expanding remittances.

PROMOTING GENDER EQUALITY

Gender is integral to the key themes of this report including growth, governance and stability (Box 5.2). While gains have been made, gender inequalities in health and education are still striking. Two-thirds of the 800 million people in the world who lack basic literacy skills are female. Girls are twice as likely to die from malnutrition and preventable diseases as boys, and half a million women die each year from complications during pregnancy – 99 per cent of them in developing countries.⁸⁹ Investments in women's and girls' education and health (including reproductive health) yield some of the highest returns of all development investments, including reduced rates of maternal mortality, better educated and healthier children, and increased household incomes.

We recommend the aid program significantly scale up its investment in women's reproductive health, including family planning (in a manner consistent with current guidelines on Australian family planning assistance). To have a significant impact, these interventions need to be large – small gender components attached to larger projects rarely have an impact.⁹⁰

Gender equality extends beyond improving female health and education. AusAID's gender policy, *Gender and Development: Australia's Aid Commitment* has five objectives: to improve women's access to education and health care; to improve women's access to economic resources; to promote women's participation and leadership in decision making at all levels; to promote the human rights of women and assist efforts to eliminate discrimination against women; and to incorporate a gender perspective in the aid program. Mainstreaming the gender policy into country strategies and implementation is an ongoing challenge. Building on the outcomes of the AusAID 2002 gender policy review, priorities for mainstreaming need to be identified. For example, gender inequality is a major driver of the spread of HIV/AIDS and more attention needs to be given to this if HIV/AIDS is to be contained. Pilot studies and research in areas such as women's role in improving

BOX 5.2 GENDER, GROWTH, GOVERNANCE AND STABILITY

Recent work, summarised below, has highlighted the links between gender on the one hand and growth, governance and stability on the other.

Gender and growth: Economic growth provides women with new opportunities and promotes gender equality. Increases in women's labour force participation results in improved productivity and hence reinforces economic growth. Investments aimed at fostering growth, including microentrepreneur programs for women and infrastructure programs involving women, can have significant impacts on gender equality.

Gender and governance: There is evidence to suggest that women's involvement in elected bodies leads to more socially-minded spending agendas and reduced levels of corruption. However, levels of female participation (both on the demand- and supply-sides) in decision making in our region are low. In PNG for example, there is only one woman out of a total of 109 representatives in the national parliament. Investments that promote women's involvement in the decision making process, either by supporting women's groups or promoting the development of female leaders, can result in more responsible governance and greater gender parity.

Gender and stability: Instability and conflict affect women disproportionately, through increased rates of domestic violence, displacement, loss of family income, and greater responsibilities for the family and community. Women play a crucial role in peace-building and ending conflict, as demonstrated in Bougainville, PNG, Solomon Islands, Fiji and Mindanao, Philippines. By supporting women's groups and the involvement of women in decision making, the aid program will promote stability and gender equality.

Sources: Coleman (2005); Jütting and Morrison (2005); Swamy (2005); World Bank (2001); www.ausaid.gov.au/publication/html/decision_making.cfm

89 UNDP (2005)

90 Swamy (2005)

governance and their contribution to peace and stability, would allow AusAID to trial innovative approaches and strengthen its expertise on fragile states. Working with men and boys is also essential to achieving gender equality. Interventions targeting men and boys can make major contributions to reducing violence against women and gender inequality. Significantly more attention needs to be given to the problem of domestic violence in particular.

Recommendation 5.13 *Promote gender equality by:*

- (a) *emphasising women's and girls' education and health, including reproductive health and family planning*
- (b) *strengthening gender mainstreaming.*

5.D REGIONAL STABILITY AND COOPERATION

In an increasingly globalised world, the nation state may not always be the correct unit of analysis or operation. Many of today's threats to development and underlying stability cross national boundaries. Conflict, terrorism and disease will quickly flow across national borders into other countries. National stability is increasingly determined by broader regional stability and national policies must increasingly factor in spill-over effects from across borders. Many of today's development solutions therefore require coordinated action across a group of states. In the course of White Paper consultations, three areas have emerged as ones where fundamentally regional approaches need to be taken.

First, Australia should promote regional responses to transboundary threats. This covers a range of threats to development and stability: from pandemics, disasters and global warming; to water access and transnational crime, including people smuggling, illegal fishing, drug trafficking, money laundering and terrorism. These problems demand not only national but also transnational responses, based on a good understanding of the risks and of effective policies and programs. At a minimum, this requires dialogue and cooperation between source and affected countries, to reduce negative spill-overs and tensions.

Recommendation 5.14 *The aid program should promote regional understanding of, and responses to, transboundary threats to stability and development.*

Second, Australia should support an expanded range of regional integration initiatives. Australia has provided long-standing support to the ASEAN Secretariat (now stretching back over a period of over 30 years), which has helped facilitate cooperation between ASEAN members. AusAID has also supported the APEC forum effectively. Given Australia's track record in provision of assistance to organisations that promote regional integration and cooperation, we propose an expansion of this role. The Greater Mekong Subregion Program⁹¹ would be a prime candidate for greater support by Australia. Australian aid should also reflect the likelihood of greater integration within Asia – between South Asia (the Indian sub-continent) and East Asia. It remains to be seen what will emerge from the East Asia Summit in December 2005, but the very fact that India will attend as a founding member suggests that East Asia is looking west and South Asia is looking east. From this perspective, organisations such as the South Asian Association for Regional Cooperation and the Bay-of-Bengal (BIMSTEC) grouping, which brings together East and South Asian countries, warrant greater attention as instruments for promoting regional cooperation and integration than they have received so far.

Recommendation 5.15 *In Asia, the aid program should support an expanded range of regional cooperation initiatives, based on a careful assessment of their contribution to effective regional integration.*

Third, in the Pacific Islands, Australia should give greater weight to support for regional governance solutions. Small governments are more expensive than big ones since fixed costs (such as developing new policies) are shared amongst fewer citizens. Small governments also find it difficult to impose impartial rule due to the problem of familiarity – everyone knows everyone. With advocacy by the Australian Prime Minister and others at recent Pacific Island Forum meetings, factors such as

91 See www.adb.org/GMS/program.asp

these are driving the Pacific Islands towards a more regional approach as embodied, for example, in the Pacific Plan, which was endorsed by Forum leaders in October 2005. This embodies a number of proposals for regional action, in areas ranging from establishment of regional economic and statistical centres, to regional audit and ombudsman arrangements. Another proposal worthy of consideration is the establishment of a clearing house which would support comparative analysis, benchmarking, and the sharing of good practices and lessons learnt.

While a number of regional activities are already supported by AusAID, the Australian aid program currently lacks a consistent framework for deciding when to intervene in the Pacific on a regional or on a country-specific basis. Using the Pacific Plan and related analytical work as a guide, AusAID should develop such a framework. This could lead to significant changes in the way assistance is delivered, and a more regional orientation to its work in the Pacific.

Recommendation 5.16 *In the Pacific Islands, the aid program should:*

- (a) *continue and expand support for **regional governance** solutions*
- (b) *develop a framework for deciding when to assist in the Pacific on a regional or country-specific basis.*

5.E CONCLUSION

The Australian aid program has shifted over recent years to give much more focus to governance. We commend this. We recommend that the objective of helping states govern better, especially weak states, be addressed less through technical assistance and more as an overarching theme of the entire aid program, and with a greater emphasis on political governance.

The potential increase in the aid budget over the coming years also provides an opportunity to expand support for what we have termed the drivers of growth – such as skills training, infrastructure and rural development – and for greater emphasis on

investing in people through support for education, health and gender equity. We also recommend that a more regional approach be taken to the provision of development assistance.

Success under each of the four themes needs to be judged in terms of the indicators developed for individual AusAID country strategies and activities. These would establish primary program accountability. However, it would also be useful to have measures of ‘overall success’, which would allow one to step back and ask if fundamental goals are being achieved. These could be developed as follows:

- > Success in the promotion of economic growth could be judged by reference to key partner countries’ growth rates and their rate of income poverty reduction, including in relation to the MDG target of halving poverty by 2015. Relevant targets for environmental sustainability would come out of the recommended new environmental strategy.
- > Success in helping states function more effectively could be judged against various indicators of policy and institutional performance for AusAID’s key development partners, including the World Bank’s Country Policy and Institutional Assessment.
- > Success with regard to investing in people could be judged by reference to a country’s performance against their national health, education and gender equality targets, or the relevant MDG targets, which have been adopted by most of Australia’s development partners. The latter cover primary education, maternal and infant mortality, and the rolling-back of HIV/AIDS and malaria.
- > To judge success in the area of regional stability and cooperation, individual indicators will need to be developed for each of the three areas outlined (regional cooperation, Asian integration and Pacific regional governance).

6 Maximising Aid Effectiveness

Aid volumes, even if increased, will remain small relative to the challenge of global poverty. Since there are so many activities that an aid program could support, the more important challenge is ensuring that whatever the aid program does, it does well.

AusAID already does many things well. As discussed earlier (see Chapter 3), it has an international reputation for responsiveness, pragmatism and flexibility. One of the challenges facing AusAID is to retain these strengths at a time of scaling-up – an issue we return to in this report’s conclusion. But there is also scope for improving effectiveness. This is particularly important in the context of the Prime Minister’s announcement of Australia’s goal to increase aid subject to ‘the effectiveness of the application of additional resources’ (Chapter 1). We propose four strategies towards this end:

- > strengthening the performance orientation of the aid program
- > combating corruption
- > integrating with and broadening Australia’s engagement with the Asia–Pacific region
- > working in a partnership mode, with both recipient countries and other donors.

6.A STRENGTHENING THE PERFORMANCE ORIENTATION OF THE AID PROGRAM

The best way to improve performance is to set out to do just that – set targets and then seek to achieve to them. This is easier said than done. On the one hand,

attempts to evaluate individual interventions run the risk of missing the wood for the trees in that they can hardly be considered successful if they perform well but overall development is absent. On the other hand, attempts to judge the aid program by reference to overall development progress are subject to the criticism that there are surely other much more important determinants of country performance than the contribution made by any aid program, let alone a relatively small one such as Australia’s.

Given that no single performance framework for aid will be found satisfactory, a culture of performance needs to be developed. Performance should be measured in multiple dimensions from adherence to quality processes during activity design and implementation, to monitoring of activity inputs, to evaluation of outputs and outcomes, and to overall country performance assessments. If one visualises a hierarchy of performance assessments from the country level down to the individual activity level, our recommendation is that AusAID focus on all the levels in the hierarchy. AusAID needs to re-position itself accordingly and give performance monitoring and learning greater prominence.

Over time, AusAID has strengthened its performance management function. Existing quality control arrangements are as follows:

- > *Application of quality processes in design and implementation:* A newly introduced Annual Quality Review monitors compliance with quality standards during design, including

peer-review requirements. A Quality Assurance Group annually assesses a random sub-set of projects and rates them as satisfactory or unsatisfactory.

- > *Monitoring of activity inputs and outputs:*
Each activity is reviewed regularly, and rated satisfactory or unsatisfactory. There is a target of 75 per cent for the proportion of activities rated satisfactory. The Quality Assurance Group also regularly undertakes quality of implementation reviews.
- > *Evaluation of activity outputs and outcomes:*
AusAID program areas are responsible for sourcing Independent Completion Reports; ex-post evaluations of a smaller number of activities are undertaken by the Evaluation Section and by individual programs.
- > *Evaluation of outcomes at the country level:*
Performance monitoring is also starting to be undertaken at the country level, with an overall impact assessment of Australian aid to PNG (AusAID, 2003d).

Other agencies with ODA responsibilities have less elaborate performance monitoring arrangements, except for ACIAR which has an extensive impact evaluation system that includes the commissioning of a number of external evaluations.⁹² It is clear, recent improvements notwithstanding, that more can be done to strengthen existing performance arrangements. We present below six recommendations on how this can be done. Adoption of these recommendations will place the Australian aid program at the forefront of global efforts to improve development effectiveness, and put it in a powerful position to shape global debates on aid and effectiveness.

First, build performance into individual activities through increasing reliance on approaches that link payments to deliverables. The best way to move towards a performance orientation is to embed it in the core work of the agency, that is, through the various aid activities. There are two main ways in which this can be done:

- a) All activities should include plans for monitoring and evaluation, and the implementation of these plans needs to be improved. The primary measure of AusAID's performance is that it exceeds a target of 75 per cent for the number of projects judged satisfactory. Internal ratings of projects suggest that 90 per cent of projects are rated satisfactory. This rating is undertaken by the staff and contractors working on the project. More independent reviews suggest that the number of satisfactory projects is in fact hovering around the 75 per cent mark. While this is still an impressive success rate, it would be opportune to undertake a review of portfolio management with the aim of further enhancing the robustness of activity ratings, to narrow the disconnect that seems to have emerged between own-ratings and more objective ratings, and to more pro-actively manage 'problem projects' to take them out of that status.
- b) For activities where there are clearly defined outputs, it is possible to structure the intervention around the results it is intended to achieve. The World Bank, together with the Global Partnership on Output-based Aid, has been piloting this approach and so far has 50 output-based projects underway. The Global Fund to Fight AIDS, Tuberculosis and Malaria is based entirely on performance-based funding – apart from an initial disbursement, all funding is subject to performance against agreed targets. Underlying this output-based or results-based approach is the fact the aid is only paid once results are achieved, so the less successful the project, the lower the commitment. This has several obvious advantages: it aligns incentives of service-delivery agencies behind the desired outcomes; it insures funding agencies against failure; and it makes a performance orientation essential to the functioning of the intervention rather than an optional add-on. While output-based principles cannot be applied to all projects (capacity building interventions are difficult to design in this way, as AusAID's own experience suggests),⁹³ they can be applied

⁹² This involves the commissioning of independent impact assessment studies which are peer reviewed and published in the *Impact Assessment* series.

⁹³ During the 1990s AusAID used outputs-based contracts for the delivery of major capacity building activities. These contracts contained a defined scope of services, were fixed in price and the contractor was paid lump sums upon the completion of payment milestones (measurable output performance indicators). A 2000 review pointed to numerous problems with these outputs contracts including a lack of flexibility. AusAID has since shifted to hybrid contracts for capacity building activities, which provide payment on the basis of both inputs and outputs. This experience is quite consistent with our advocacy of output-based aid where outputs can be more easily measured, which is typically in infrastructure and social sector projects.

BOX 6.1 OUTPUT-BASED AID: LINKING FUNDING WITH RESULTS

There is now a wide range of experience with output-based projects, implemented by a large number of actors. A few examples follow:

- > In India, the Azim Premji Foundation, under its Learning Guarantee Program, rewards schools with cash grants if they are able to achieve 100 per cent enrolment, 90 per cent attendance, and acceptable results in competence tests.
- > In Chad, and several other developing countries, the maintenance responsibility for entire road systems has been contracted out to private companies. These companies are paid on a per kilometre basis to maintain the roads to pre-specified quality levels.
- > In Cambodia, water-supply companies are provided with subsidies once poor households are connected and receiving water supply.
- > In Nepal, private telecommunications companies are subsidised for network roll-out in rural areas – the payment is given as agreed milestones for roll-out are achieved (e.g. against the number of households connected).
- > The Global Fund to Fight AIDS, Tuberculosis and Malaria has implemented a performance based approach to the provision of grants. Output targets are identified and performance against these targets is independently measured at regular intervals throughout the life of the grant. Disbursement of funds is based on an assessment of performance against targets. To date, the Global Fund has approved grants worth US\$3.9 billion in 127 countries.

Sources: www.azimpremjifoundation.org; www.gpoba.org; <http://www.theglobalfund.org/en/>

to a wide range of activities in the social and infrastructure sectors. We suggest that this approach be increasingly utilised within AusAID and that Australia collaborate with and extend support to the Global Partnership for Output-based Aid.

Recommendation 6.1 Build performance into individual activities *through better monitoring and increasing use of output-based or results-based approaches to aid, where practical.*

Second, strengthen the link between performance and allocations, between and within countries. In the World Bank and ADB, allocations of concessional aid are made on the basis of performance as well as poverty.⁹⁴ Such a systematic link may not be possible for Australia given bilateral imperatives and the safety net and rescue functions that the aid program is often called upon to fill in weakly performing countries. At the same time, however, it should be possible to make a closer link between allocations and performance, at least at the margin. At the country level, separate funds can be created and disbursed against improvements in performance, for example, as measured by the composite policy and institutional indicators developed by the World Bank and ADB. Such funds can lead to a competition in which better performance is rewarded by higher funding. It would be possible to also develop competitive funds for countries that show reductions in corruption (as measured by corruption surveys) or improvements in business regulation (as measured by indicators such as the number of days it takes to register a business). The rewards for such achievements could either be given in an untied manner to maximise incentives, or they could come as additional allocations for existing projects. Such interventions could be well suited to the Pacific.

In larger countries, incentives can be used to get within-country agencies to compete for funds. For example, local governments can be made eligible to receive grant funding if they meet specific performance benchmarks. An October 2003 AusAID document on the subject noted that ‘the

94 For example, the World Bank uses the Country Performance and Institutional Assessment to measure country performance.

BOX 6.2 INCENTIVES IN THE AUSTRALIAN AID PROGRAM

The 2002 Ministerial Statement affirmed incentives and contestability as key principles of Australia's aid program. Experiences have highlighted a number of lessons for ongoing and future efforts.

- > **Between countries and organisations:** The Policy and Management Reform (PMR) Fund involves resources being allocated competitively between Pacific countries and programs on the basis of demonstrated commitment to reform. Experience to date suggests that some leverage was initially exerted through this allocation process, but this appears to have become less effective over time.
- > **Between organisations within a country:** The PNG Incentive Fund (PNGIF) was established to encourage policy reform in PNG through building an incentive-based funding mechanism, and to provide direct assistance to private and public sector organisations. While performance of the PNGIF has been mixed, reviews have been positive about the Fund's concept and the possibility of using incentives to motivate behaviour change in PNG.
- > **Between provincial governments:** The PNG Sub-National Initiative (SNI) aims to provide incentives for improved governance through making assistance available to better performing and improving provinces, and through the way in which assistance is provided. Under the SNI, provinces become eligible for direct financial support where progress on provincial budget and public administration issues can be demonstrated.

- > **Within an agency:** A PNG Correctional Services Development Project, completed in 2003, included an incentive scheme recognising performance of Commanding Officers in prisons. There was clear evidence that incentives achieved positive results, particularly in terms of encouraging improved operational practices and compliance with accountability and reporting.

Other examples include support for PNG's Health Services Improvement Program; the Philippines-Australia Vulnerable Groups Facility; and funding arrangements with Pacific Regional Organisations. New approaches being developed include an incentive-based mechanism for providing funding through the Vanuatu Government's own systems. Opportunities for providing assistance to Vietnam tied to performance and policy triggers are also being evaluated.

Experience to date has taught a number of broad lessons:

- > significant funds are required to leverage partner government reform
- > a limited competitive market of potential recipient countries or organisations, particularly those on the margin of reform, can affect the success of either the allocation-efficiency and especially the behaviour-change purposes of contestability and incentives
- > comparing agencies' current performance with their own past performance, and rewarding incremental change is preferable to making cross-sectional comparisons
- > it is important to use clear and verifiable criteria at a level under the control of those competing for awards.

Source: AusAID (2003b); Downer (2002)

role of incentives to promote change and improve aid effectiveness has emerged as a key innovation in the Australian aid program.⁹⁵ AusAID's experience with incentive based approaches is outlined in Box 6.2. A renewed effort is needed in this area. The growing importance of sub-national governments also gives an opportunity to support better performing governments (section 5.B), and thus to demonstrate to all sub-national governments that good governance will not only attract aid funding but will also deliver results for voters.

How incentives and performance can best be built into aid is a subject that would also benefit from new research. An aid agreement is akin to a contract between the giving and receiving countries, and contract theorists should be able to provide advice on how best such an agreement can be structured to induce good performance. Careful application of existing theory and evaluation of various aid approaches should help AusAID develop more effective means of linking allocations to performance.

Recommendation 6.2 Strengthen the link between performance and allocations *between and within countries to encourage and reward good performance, and undertake further research on how incentives and performance can best be built into aid programs.*

Third, strengthen the evaluation and lessons learnt function through the establishment of an Office of Development Effectiveness. Evaluation provides the critical feedback without which learning is impossible. Evaluation within AusAID is currently a function of one of three sections within the Office for Review and Evaluation (ORE). The other two sections within ORE are internal audit and quality control. ORE reports to a Deputy Director General of AusAID. These arrangements suffer from several deficiencies. While both the central evaluation unit and the various operational branches have an evaluation mandate, in practice many projects are not evaluated at all, except perhaps by the implementing contractor, who obviously has a strong vested interest. There is also little by way of evaluation of other departments' development activities, which, as discussed in Chapter 2, are of increasing importance.

We recommend that ORE be replaced by a stronger and more independent Office of Development Effectiveness (ODE), with responsibilities for both quality monitoring and evaluation. In particular, we suggest the following:

- > ODE should publish an Annual Review of Development Effectiveness, drawing on the range of its work, from quality process reviews to concurrent and ex-post evaluations, and drawing on the experiences of all Australian agencies delivering ODA. The Annual Review would be integrated into the Government's budget cycle through the Expenditure Review Committee, and provide a practical link between expanding allocations and increased effectiveness, as per the Prime Minister's announcement.
- > ODE should be an important resource for all Australian government agencies delivering ODA-eligible expenditure. The ODE Annual Review would cover all ODA, and agencies apart from AusAID should be given the opportunity to participate in ODE activities and benefit from ODE feedback, either through evaluations and/or from knowledge sharing with the ODE.
- > To give it a higher profile and strengthen its independence from operational management, we suggest that ODE report directly to the AusAID Director General and be guided by its own Steering Committee, which would consist of representatives of the various ODA-providing departments, as well as internationally recognised experts.
- > More resources need to be committed to evaluations. The present volume of evaluations is simply not enough for adequate learning. ODE should be given a separate budget and separate hiring processes.
- > ODE evaluations (and also management responses) should in general be made public.
- > ODE should be encouraged to evaluate not only individual interventions, but also country strategies, (undertaken in time to feed into the development of future country strategies) and thematic clusters of projects.

95 AusAID (2003b)

- > Completion reports should be undertaken for all activities (say of a minimum size), and published, as is the practice for the World Bank. This practice will provide the currently missing database on development effectiveness. Completion reports, rather than in-depth evaluations of a few projects, should be the job of the operational branches. ODE, apart from undertaking in-depth evaluation of a few projects, should undertake a desk review of all completion reports, and on this basis establish its own ratings for projects.
- > ODE should also be responsible for disseminating lessons learnt from evaluations and experiences of other Australian and international agencies, and establishing links with key counterparts such as the World Bank, DAC and DFID, as well as research institutions and think tanks dealing with development effectiveness issues, such as the Center for Global Development in the US and the UK Overseas Development Institute.

This set of arrangements would, in our view, strike the right balance between independence and relevance. They would put Australia at the forefront of bilateral donors in terms of rigour and strength of aid evaluation. Introducing them now, just as the aid budget is set for major expansion, would be propitious.

Recommendation 6.3 *Strengthen the evaluation function through the establishment of an Office of Development Effectiveness which would:*

- (a) *take responsibility for both quality monitoring and evaluation*
- (b) *publish an Annual Review of Development Effectiveness*
- (c) *report directly to the AusAID Director General, have its own budget and be a resource for all Australian government agencies delivering ODA.*
- (d) *evaluate country strategies as well as individual interventions.*

Fourth, increase public disclosure. It is a basic tenet of governance reform that transparency will promote increased scrutiny and improved performance.

While AusAID has increased disclosure over time, international practices have also changed. The disclosure practices of the World Bank are a case in point. It is recognised that as a bilateral government agency, issues of political sensitivity and inter-country relationships need to be sensibly factored into disclosure policies. We recommend that AusAID develop a disclosure policy and adopt appropriate measures relating to information (on country strategy, activity performance, et cetera) which sees disclosure as the first option.

Recommendation 6.4 *Develop a policy that would increase public disclosure levels relating to the aid program.*

Fifth, work with partner countries and international agencies to improve performance monitoring. Ultimately, what matters is not how developing countries perform against standards set by external funders, but how they perform against targets which they themselves set. As AusAID moves to work more closely with partner governments, it should help those governments improve how they monitor their own performance through strengthened statistical capacity and budget–performance links. AusAID should also support and participate in international evaluation efforts to contribute to the international pool of knowledge on what works and what doesn't in development. These could include the World Bank's Development Impact Monitoring and Evaluation Initiative (DIME), the Evaluation Initiative of the OECD DAC, and the Evaluation Club proposed by the Centre for Global Development.

Recommendation 6.5 *Work with partner countries to help them better monitor their performance; and collaborate in international efforts to improve evaluation.*

Sixth, upgrade the country strategy to give greater prominence to performance outcomes and provide a single framework for whole-of-government development efforts. AusAID has a well developed country strategy process. There have already been some efforts to introduce performance frameworks to attempt to assess the impact of Australian aid at the broader sectoral or country level (e.g. Vietnam). In spite of the difficulties inherent in such an exercise, we recommend this be given greater attention

in the future for major partner countries. These performance frameworks will provide the basis for review and evaluation of country strategies by the proposed ODE. Further, the country strategy should provide a single objective and framework for all Australian ODA efforts, that is, by AusAID and other Australian government agencies. AusAID should remain at the centre of the country strategy process but this will demand a more inclusive approach by AusAID during country strategy deliberations than is currently the case. The country strategy should also be a prime vehicle for mapping the generic issues identified in Chapter 5 into country-specific contexts, that is, to understand the binding constraints to development and the political economies of reform that vary from country to country, and to exercise selectivity. Ideally, the country strategy should also consider issues surrounding non-aid policies and their impact on development in that particular country.

For major partners, making operational the idea of ‘mutual obligation’ put forward by Hughes (2003) would make explicit the responsibilities of both parties. This could be done through compacts or performance agreements, as suggested by the analytical report on PNG. However, it is important to be realistic and to avoid such agreements being held to a single ‘make-or-break’ issue. International experience with conditionality suggests that behaviour should be given more weight than promises, and that there is no point making threats that lack credibility. It is not possible for Australia to ‘walk away’ from some of our partner countries. It may, therefore, be more feasible to reward good performance, rather than punish bad. That said, poor performance should not go unnoticed, but should trigger alternative engagement strategies in line with current thinking on fragile states (e.g. support through non-state actors). The most sensible and effective approach to the development of a performance agreement would be to operationalise it through a country strategy, with explicit targets agreed with partner governments.

Recommendation 6.6 *Upgrade the focus on country strategies as the key planning and review document for Australian development efforts to major partner countries. They should:*

- (a) *include all ODA-eligible activity*
- (b) *ensure selectivity*
- (c) *provide a more rigorous performance framework*
- (d) *operationalise performance agreements with partners.*

6.B COMBATING CORRUPTION

Corruption undermines aid effectiveness. In a survey of African opinion-makers it was found that 84 per cent of respondents agreed with the statement that, ‘Because of corruption, foreign assistance to developing countries is mostly wasted.’⁹⁶ The Prime Minister announced that increases in Australian aid will ‘be conditional on strengthened governance and reduced corruption in recipient countries.’ We have already discussed the importance of focusing the aid program on helping governments function better (see section 5.B). Efforts in this direction will clearly be central to reducing corruption. In this section, we focus more concretely on how best to link the aid program to efforts to reduce corruption.

To begin with, we must recognise how small Australia’s aid contribution is, relative to the size of the economies it is seeking to assist. There are only a handful of economies that are both heavily reliant on aid and where Australia makes a significant contribution. Of the 14 countries budgeted to receive ODA of \$20 million or more in 2005-06, this group consists of only four: Solomon Islands, Vanuatu, Samoa, and, to a lesser extent, PNG. In others, either aid as a whole is small relative to the size of the economy (China, Indonesia and Philippines where aid is less than one per cent of GNI; and Fiji, Sri Lanka, and Vietnam where aid is in the range of one to five per cent of GNI); or aid is important, but Australia’s contribution is small (Laos and Cambodia).⁹⁷ Trying to establish a direct

96 As cited in Burnside and Dollar (2004).

97 Total aid data for 2003 from the World Bank Development Statistics Online.

BOX 6.3 ANTI-CORRUPTION AND THE AUSTRALIAN AID PROGRAM

The Australian aid program has long sought to help address corruption in partner countries. More than a third of Australia's aid budget (\$885m in 2005-06) is devoted to governance programs that aim to improve the accountability and performance of developing country governments. Much of this assistance directly or indirectly helps to reduce corruption by improving systems and processes and building stronger institutions.

More directly, the aid program has sought to address corruption principally by strengthening the supply-side institutions that provide the formal checks and balances in government systems. More recently this has extended to building the internal demand for anti-corruption.

AusAID's programs contribute to reducing corruption in three principal ways:

Enforcement: boosting the capacity to investigate and prosecute corrupt activity. For instance, the Ombudsman Commission Institutional Strengthening Project (OCISP) in PNG addressed system and human resource constraints that were hampering the PNG Ombudsman Commission's ability to effectively discharge its constitutional responsibilities. Through the OCISP, the Ombudsman Commission underwent profound change, emerging as a leading public sector agency and one of the key agencies combating corruption in PNG through its role in overseeing the PNG Leadership Code.

Prevention: strengthening government institutions to reduce the incentives and opportunities for corruption. For instance, Australia is providing

\$34 million from 2005 to 2010 to a World Bank project that is helping to reform the Philippines land administration system. The project will give greater clarity to land title and related rights to allow for more efficient property markets and diminish the system's susceptibility to corruption.

Education: working with non-state actors such as universities, churches, media, business and advocacy groups to promote support for better governance. For example, Australia is providing \$2.1 million over three years to strengthen demand for good governance in the Pacific, through support for better political, business and economic reporting and improved standards of investigative journalism. This assistance also aims to improve ethical standards, media laws and coverage of regional governance meetings.

To promote understanding of corruption in different country settings, Australia has funded a series of studies on corruption undertaken by Transparency International. Known as National Integrity Studies, these studies sought to describe the nature, manifestations and drivers of corruption in the Pacific as part of a global series.

Australia is also an active player in international anti-corruption forums that encourage nations to enact international anti-corruption standards and provide for legal cooperation between nations. These include funding and participating in the Asian Development Bank/OECD Anti-Corruption Initiative for the Asia-Pacific and supporting the Asia/Pacific Group on Money Laundering.

link between aggregate Australian assistance and overall governance/corruption performance for the Asia-Pacific region is, therefore, not going to be very helpful. A more nuanced and carefully constructed approach is required. We suggest three prongs.

Mainstream anti-corruption: Just as the best way to develop a performance orientation is to embed it within individual activities, so the most effective way the aid program can reduce corruption is to

embed this objective within individual activities and country strategies. Each major activity should, as a matter of course, set out what it is doing not only to reduce risks of corruption to the activity, but also to reduce corruption in the sector in which it is located. This will encourage pilots and initiatives to promote public disclosure and other transparency mechanisms that will reduce corruption. Country strategies should also set out how the aid program

will help to reduce corruption. It would also be useful if AusAID developed an anti-corruption strategy in partnership with other key agencies (see next paragraph), covering the three main areas of enforcement, prevention and education.

Recommendation 6.7 *Mainstream anti-corruption in the aid program, including through a new anti-corruption strategy.*

Adopt a whole-of-government approach to anti-corruption: Anti-corruption is an important area for whole-of-government approaches – for example, to bring together AusAID’s corruption education and prevention efforts with the work of the Australian Federal Police (AFP) and Attorney-General’s Department (AGD) on anti-corruption enforcement, and legal framework and cooperation. Efforts to tackle the ‘supply side’ of corruption are also important. More generally, it would be extremely useful if the proposed anti-corruption strategy could be prepared and then implemented as a whole-of-government strategy for the aid program, rather than simply as an AusAID strategy. Partnerships with other donors and groups working on anti-corruption efforts, such as Transparency International, are also important.

Recommendation 6.8 *Adopt a whole-of-government approach to the reduction of corruption in Australia’s development partner countries.*

Support regional and global initiatives to combat corruption: These include the ADB-OECD Anti-Corruption Initiative for Asia and the Pacific, the work of regional fishery bodies on illegal fishing,⁹⁸ governance aspects of the Pacific Plan, and Transparency International. Given the deep problems of corruption that mining projects have given rise to in many countries, support for and assistance to countries to implement the Extractive Industries Transparency Initiative would seem particularly important.⁹⁹ Over time, similar principles could be extended to the natural resource sectors.

Recommendation 6.9 *Support regional and global initiatives to combat corruption, including the Extractive Industries Transparency Initiative.*

6.C INTEGRATING AND BROADENING AUSTRALIA’S ENGAGEMENT WITH THE ASIA–PACIFIC REGION

As we noted in Chapter 3, one of the lessons from the past decade is that development goes well beyond aid. Developed country policies in areas such as trade and migration can often have more of an impact on developing country prospects than aid. Even in the delivery of aid, one lesson Australia has learnt is that in some areas this can be more effectively done through a whole-of-government approach rather than through a single agency. Nor should engagement on development be seen only through a governmental lens. Rather, the aid program should seek to catalyse a broader Australian engagement with its region. In this section, we outline recommendations for a more integrated engagement on development issues in the Asia–Pacific region within government, and then for a broader societal engagement with these issues.

TOWARDS AN INTEGRATED GOVERNMENT ENGAGEMENT ON DEVELOPMENT

Policy coherence: Australia has a strong record on policy coherence for development.¹⁰⁰ Given the importance of non-aid issues for development, and that development in our region is central to Australia’s national interest, we recommend AusAID maintain and further develop its engagement on broader Australian government policies that impact on development. Many of these policies are favourable: we are a high-migration country with an open trade regime, though we do highlight the need for change to the labour mobility regime with respect to the Pacific (see section 7.B). More detailed study is required on other issues. For example, the HIV/AIDS analytical report recommends Australia work in the trade arena to reduce the cost of HIV/AIDS treatment drugs. Such issues should be

98 For more on this issue, see OECD (2005b).

99 At the time of writing, from the Asia–Pacific region only East Timor had joined.

100 The Center for Global Development’s Commitment to Development Index rated Australia 4th out of 21 OECD countries in 2004 and 2005 against a range of areas relating to development, including policies on trade, migration, aid, security, technology and environment.

taken up more pro-actively by AusAID as part of its development mandate, in collaboration with relevant Australian government agencies.

Recommendation 6.10 *AusAID should build on and develop its engagement on whole-of-government development issues, in collaboration with the concerned departments and agencies.*

Political governance: We stressed in the previous chapter the importance of giving greater emphasis to political governance. Work in this area can raise sensitive but important issues, where little progress will be possible without political engagement at the highest level. AusAID needs to take every opportunity to promote this engagement. One practical suggestion is the formation of a dedicated Australian parliamentary group on the Pacific to build links with their Island counterparts.

Recommendation 6.11 *Promote political engagement on development issues relating to political governance, including pursuing the formation of an Australian parliamentary group on the Pacific.*

Building on the strengths of a whole-of-government approach: One of the biggest shifts in the aid program since the last review in 1997 is the increased involvement of other government agencies in the delivery of the aid program (see section 2.D). A large part of this increase represents increased spending by the Australian Federal Police in Solomon Islands under RAMSI and in PNG under ECP.¹⁰¹ Barring further regional emergencies, it is unlikely that the current proportion of non-AusAID spending will be sustained in the future. Nevertheless, the increase in importance in non-AusAID ODA goes well beyond the AFP and significant non-AusAID funding is likely to remain a feature of the Australian aid scene. Other bilateral agencies have experienced similar trends (e.g. Canada and USA) but according to the recent DAC review of the aid program, the whole-of-government approach to aid has been taken further by Australia than other developed countries.

There are clearly advantages in this approach. It draws in skills to the aid program from a diverse set of areas – from environment, education and health to economic policy and financial management. It gives the aid program a much higher profile within government, and it helps build long-term linkages between Australian and key developing country institutions. There are still opportunities where more of a whole-of-government approach could be beneficially pursued. For example, as mentioned earlier, there are synergies to be gained from bringing together AusAID’s corruption prevention efforts with AFP and AGD anti-corruption enforcement work.

There are also potential disadvantages to the whole-of-government approach. In recent years there have been major new whole-of-government driven initiatives with Australia’s three most important partners (PNG, Indonesia, and Solomon Islands) that have been implemented alongside substantial existing bilateral development programs. While Indonesia now has a shared single strategy under the AIPRD Partnership Framework, neither PNG nor Solomon Islands has a single shared strategy to guide Australian aid activities, which could result in opportunities and synergies being missed. To maximise the impact of Australia’s development investment, we recommend a shared strategy and implementation framework be developed for major partner countries (see the earlier discussion on whole-of-government country strategies in section 6.A).

There is also the issue of when a development initiative should be undertaken through government departments and when it should be out-sourced. It is difficult to come up with rigorous guidelines to use in making this choice, but it is important that contestability be maintained and that the aid program be open to the strengths of both approaches.

Finally, AusAID has an important role to play in making the whole-of-government approach work. It will often need to take a leadership and coordinating role. It needs to continually encourage other departments to give international development the

101 About half of the increase in other government department expenditure in 2004-05 relates to AFP expenditure on ECP and RAMSI.

attention it deserves. And it should ensure provision of training in order to develop understanding of the country-specific circumstances and culture in which the various government agencies will be operating. The proposed Office of Development Effectiveness would also have an important role to play in promoting common and high quality standards across ODA-delivering government agencies.

Recommendation 6.12 *Ensure that aid interventions by different government departments are consistent with a single development framework, ideally a whole-of-government country strategy (see Recommendation 6.6). Maintain contestability in decisions regarding aid delivery.*

A BROADER ENGAGEMENT EXTENDING BEYOND GOVERNMENT

As stressed by the analytical report on engaging the Australian community, one of the main roles of the aid program is to engage Australians with the development issues of our region, and thereby to catalyse the deployment of Australian resources to promote development. The aid program already does this in various ways, including through its support of Australian non-government organisations, volunteer programs, and its research program. Drawing on the community engagement analytical report, we list some recommendations below on what more can be done in this regard.

Research: The Australian aid program needs to boost and diversify its research investment if it is to remain relevant and effective in a rapidly changing and increasingly complex development environment. The existing research budget is dominated by agriculture, with annual spending by the Australian Centre for International Agricultural Research (ACIAR) of around \$54 million (2005-06). A strong case for scaling up this investment was made in a submission to the Core Group by the ATSE Crawford Fund. However, an increase in this area alone has to be weighed against the case for giving more priority to research support for other areas such as political

governance, growth, health and education. In any case, we would recommend that the work of ACIAR be better integrated into the rural development strategy of the aid program. This will be especially important if rural development interventions are expanded, as we recommend. Greater private-sector and non-governmental organisation participation in ACIAR research would also be important (as for the broader aid program, see section 6.D). Work in these directions has already started. ACIAR's preparation of a new corporate plan, which will commence shortly, provides an opportunity to accelerate these processes.

AusAID has a much smaller research program. It has a central research budget of about \$2.5 million (around 0.1 per cent of Australia's ODA in 2004), and country programs also fund smaller research projects. The small size of this effort is made evident by considering the recommendation of the Jackson Review in 1984 that a development grants fund of \$5 million be established: this corresponds to \$10 million today after adjusting for inflation. DFID, the United Kingdom's development agency, spent £82 million in 2002-03 on research, and plans to increase this to £100 million by 2006-07 (equivalent to around A\$230 million or 2.3 per cent of DFID's ODA in 2004). A new AusAID research strategy would sensibly consist of a mix of strategic partnerships and competitive grant rounds. While one would expect most applicants to be Australian, consistent with our advocacy of untying (Chapter 8), we do not recommend that participation be restricted only to Australian institutions.¹⁰² Research partnerships with developing country institutions should be strongly encouraged, with the aim of developing capacity in partner countries for independent analysis of and commentary on government policies and actions. ACIAR's partnership model, which brings together Australian and developing country expertise to undertake agricultural, forestry and fisheries research, is a good example in this regard.

102 The much larger DFID research fund is open to institutions from all countries. See DFID's new research framework (2005b).

Recommendation 6.13 Promote development research by:

- (a) expanding the overall development research budget*
- (b) strengthening the Australian Centre for International Agricultural Research's links with the broader aid program's rural development program and with the private sector and relevant non-government organisations*
- (c) redirecting AusAID's research fund towards a mix of strategic partnerships and competitive grants, and encourage research partnerships with developing countries*
- (d) diversifying the development research budget with more research funding for areas such as political governance, growth, health and education.*

Linkage programs: AusAID runs, or has run in the past, various linkage programs to involve Australian academics, NGOs and business groups in meeting regional development challenges. The successful Australian Youth Ambassadors for Development program, for example, is developing a cadre of Australians with deeper knowledge and ties with the region. The linking role of the aid program is of growing importance in an increasingly interdependent and uncertain world. It is particularly important for some of the issues we have stressed, from political governance to HIV/AIDS.

We set out below a number of ways in which the various linkage programs which AusAID runs can be strengthened and expanded. At the same time, as the analytical report on engagement with the Australian community noted, the aid program cannot and should not try to be all things to all groups. Similarly, simply funding all good intentions may not make good sense developmentally, and in some cases, may create difficulties for broader bilateral relationships. One needs to be cognisant of the perceived position or status that support provided by the Australian Government has within recipient countries. A selective and prioritised approach will be needed to maximise impact and minimise administrative burden (partly by outsourcing administration of many of the proposed linkage initiatives), and to ensure proper standards of accountability. While more detailed analysis and prioritisation of individual

options will be required, consideration should be given to the following menu of linkage options.

- (a) **Academic links:** We suggest increased AusAID support for global development research organisations, such as the Global Development Network, with the aim of building more and stronger links between Australian and developing country researchers. Programs for encouraging academic exchanges and visits could also be established.
- (b) **Non-government organisations:** Just over five per cent of the aid program is delivered through Australian NGOs. Given this report's stress on strengthening societies and working more with non-state actors, and the close links between Australian NGOs and their counterparts in developing countries, it would seem sensible to make more use of the non-government community as a delivery mechanism for Australian aid where there is an alignment of interests. Accordingly, we recommend expanded support for NGO involvement in the aid program through a range of measures, but with an emphasis on cooperation agreements whereby NGOs gain support to implement programs that are part of official aid program strategies (the PNG Church Partnership Program is a good example). Government support should not be restricted to Australian NGOs. Developing country NGOs that meet the requisite standards should also be eligible for AusAID funding.
- (c) **Community-based organisations:** In the course of White Paper consultations, some groups complained that they were unable to meet the accreditation standards established by AusAID for access to NGO funding. Indeed, accreditation standards are rising over time: in 1998, 75 NGOs were accredited to AusAID, now the number is 43. While there is no suggestion that accreditation standards should be lowered, there is a proposal that a two-tier approach be adopted and that project-specific pre-requisites be established for the second, lower tier. This would enable community-based organisations that lack the formal arrangements needed to meet AusAID's accreditation standards to

qualify for small amounts of project funding, and thus further establish cross-country, people-to-people linkages. Administration of this initiative could be outsourced but with strict operating guidelines.

- (d) **Peak bodies:** AusAID needs to catalyse support for development from beyond the fairly narrow circle of development-oriented non-government organisations and community bodies. One approach followed by several other bilateral agencies (the Swedish and US aid agencies) is to enter into strategic agreements with peak bodies. These could range from medical and legal groups to local government associations, and the agreements could cover education, linkage and assistance programs.
- (e) **Business links:** One unfortunate effect of the otherwise commendable move to separate the aid program from commercial objectives has been a weakening of the link between Australian business and the aid program. While few would suggest today that the aid program should once again be subjected to commercial objectives, the aid program does have an interest in promoting business links between Australia and its partner countries, just as it has an interest in promoting academic and non-government links. At one time AusAID ran a Private Sector Linkages Program, but this has been discontinued. Some other agencies (e.g. DFID) still run such programs, not from a commercial but from a poverty-reduction perspective. We suggest that AusAID carry out a review to analyse how it can strengthen business links through the aid program – not to promote Australian commercial advantage but rather to promote business links and innovative private-sector solutions and public–private partnerships. The recent AusAID–Lowy Institute meeting on HIV/AIDS, hosted by the Minister for Foreign Affairs and attended by business groups, is an excellent example of the sort of engagement and partnership that the aid program should seek to foster.
- (f) **State and local government linkages:** State governments are already eligible for funding under AusAID’s Public Sector Linkages

Program. We recommend consideration be given to extending this program to local governments. Especially in the smaller Pacific islands, service delivery is on a scale closer to that provided by a local government than a state (let alone the federal) government.

- (g) **School linkages:** In its submission to the Core Group, the NGO Caritas recommended the development of a ‘partnership between schools and education departments in Australia and the Pacific’. We think this idea has merit, although we suggest it be broadened to an Asia–Pacific partnership. Linking schools in Australia with schools abroad would provide considerable development education opportunities, and enhance Australian children’s perceptions of themselves as global citizens.

Recommendation 6.14 *Explore ways to expand aid linkage programs in ways that maximise impact, maintain accountability standards and minimise administrative burden. Look for greater opportunities for developing country non-state organisations to participate in the aid program.*

6.D WORKING WITH PARTNERS

Aid is characterised – and its efficiency greatly reduced – by excessive fragmentation. There are too many aid agencies getting in the way of each other and imposing excessive transaction costs on governments. Making more effective use of partnerships – from better information sharing, to more delegation – will lead to more effective aid. Partnerships are needed with a wide range of parties. In this section, we explore how AusAID can better exploit partnerships with partner governments, private and non-government entities in recipient countries, bilateral agencies, and multilateral aid agencies.

PARTNERSHIPS WITH RECIPIENT GOVERNMENTS

Australian aid continues to be delivered predominantly through stand-alone, time-bound projects. By no means are all such projects necessarily bad. Indeed, some development

**BOX 6.4 PARIS DECLARATION ON AID EFFECTIVENESS:
OWNERSHIP, HARMONISATION, ALIGNMENT, RESULTS AND MUTUAL ACCOUNTABILITY**

On 2 March 2005, at a High Level Forum in France, Australia together with 90 other countries (both developed and developing) and representatives from the international development community, pledged support for the **Paris Declaration on Aid Effectiveness**. Signatories from the Asia–Pacific region include New Zealand, PNG, Solomon Islands, Indonesia, Cambodia, Fiji, Laos, Philippines, Sri Lanka and Vietnam.

In recognition of the goal to significantly increase aid volume, contributors to the declaration agreed that aid effectiveness and support for partner country development efforts must also be increased. They resolved to reform delivery and management of aid, and reaffirmed previous commitments to harmonise and align aid delivery and accelerate progress in implementation.

Parties to the Paris Declaration on Aid Effectiveness made five key commitments, with progress towards them to be monitored against quantifiable indicators:

1. Developing countries will exercise effective leadership over their development policies and strategies, and coordinate development actions.

2. Donor countries will base their support on partner countries' national development strategies, institutions and procedures. Support will include strengthening partner country development capacity, financial management capacity and national procurement systems.
3. Donor countries will work so that their actions are more harmonised, transparent and collectively effective, including in fragile states where environments of weak ownership and capacity exist and there are immediate needs for basic service delivery.
4. Donor and partner countries will strive to implement aid in a way that focuses on the desired results and uses information to improve decision making.
5. Donor and partner countries will be mutually accountable and transparent in the use of development resources, with the result of strengthening public support for national policies and development assistance.

Source: <http://www1.worldbank.org/harmonization/Paris/FINALPARISDECLARATION.pdf>

challenges will still be best addressed through a project mode of delivery. However, the shortcomings of the traditional project approach are increasingly being recognised (lack of sustainability, absence of broader impact) and AusAID has begun to move towards more programmatic approaches. Typically, these still require the contracting by AusAID of the required expertise, but they also try to involve the recipient government more in decision-making and, in some cases, funding. These approaches also require a different role for AusAID staff, with a more engaged role in policy dialogue and program supervision. Box 3.3 provides an example from Indonesia. In PNG, AusAID's funding for road maintenance is now managed primarily by partner government agencies, which are responsible for contracting out implementation. The move away

from stand-alone projects in favour of programmatic approaches should reduce fragmentation and strengthen recipient government capacity. To make the full transition to partnership will mean recipient governments assuming a greater share of responsibilities for all stages of development assistance, from priority setting to planning, delivery and implementation. Wherever possible, the partner government should be in the driving seat, with AusAID in an assisting, review and dialogue role, rather than a direct implementation role. In stronger settings, there should be a shift to funding through government budgets, whether linked to specific sectors or untied.

The 2004 Paris Declaration on Aid Effectiveness, to which Australia is a signatory, calls for closer

partnerships between aid agencies and recipient countries by the delivery of aid via the recipient country's budget, using their procurement and financial management systems wherever possible. This will not be possible in all cases, especially in fragile state settings. But in all cases projects should be designed and implemented collaboratively with recipient governments and other development partners. The closer AusAID can integrate its work with the recipient government, the more impact and buy-in it is likely to get. The recommended shift to output-based aid advocated earlier also helps provide a way forward for identifying the appropriate modes for aid delivery, with its focus on what is achieved by the intervention (the outputs) rather than the process by which the intervention is implemented (on-budget or off, and so on).

Recommendation 6.15 *AusAID should work more closely with partner governments by:*

- (a) *accelerating its move towards programmatic approaches*
- (b) *shifting away from a heavy reliance on direct implementation of activities towards a more diversified approach in which it also supports partners (governments or non-state actors, as appropriate) to implement development activities.*

PARTNERSHIPS WITH PRIVATE AND NON-STATE SECTORS IN RECIPIENT COUNTRIES

Recommending that the Australian aid program work in close partnership with recipient governments does not mean that all aid activities should be implemented through recipient governments. To the contrary, in many countries governments simply do not have the capacity to deliver a wide range of services, and there should be increasing reliance on the private and non-government sectors as delivery vehicles, especially in fragile states. Just how much can be achieved through this approach can be seen from the example of Bangladesh (Box 6.5). In spite of weak governance and high levels of corruption, Bangladesh has been able, through its reliance on large NGOs, to achieve widespread rural credit,

health and education provision to households, and accordingly has been able to show better social indicators than its neighbour, India. We note the caution of the PNG analytical report that 'more widespread use of NGOs in service delivery would weaken the pressure on government to perform' (p. 22), but suggest that this is to misconceive the job of government, which is not necessarily to deliver, but to ensure that delivery occurs.¹⁰³ We recommend that, especially in fragile settings, AusAID, and partner governments, should consider increasing the use of the private and non-state sectors as implementing agents for delivery of the aid program in the key sectors of infrastructure, rural development, health and education.

Recommendation 6.16 *AusAID, together with partner governments, should consider increasing the use of the private and non-government sectors as implementing agents for delivery of the aid program in the key sectors of infrastructure, rural development, health and education. This is particularly important in fragile states.*

PARTNERSHIPS WITH BILATERAL AGENCIES

There are numerous infamous examples of the fragmentation of aid. One close to home is that between 1997 and 2003 there were 109 separate donor-funded education projects in Vanuatu, which has a population of just 200,000 people. The Paris Declaration on Aid Effectiveness (Box 6.4) aims, among other things, to reduce this fragmentation and force common approaches across donors. This provides a useful framework against which AusAID can monitor its performance. Achieving this goal will require joint missions, coordinated provision of technical assistance, and joint analytical work. AusAID has begun to implement this agenda. For example, AusAID has started experimenting with delegation and is piloting a delegated cooperation program in Cook Islands through New Zealand's aid program.

In the short-run at least, donor coordination will be more rather than less resource-intensive unless there is much more resort to delegation. The limits of, and

103 The argument that the state's activities should match its capability is made in World Bank (1997).

**BOX 6.5 RELYING ON NON-GOVERNMENT SERVICE PROVIDERS WHEN GOVERNMENT CAPACITY IS WEAK:
THE CASE OF BANGLADESH**

It is sometimes said that support for non-state service providers undermines government accountability and is unsustainable. Bangladesh, a poor country of 140 million people, shows to the contrary that non-state actors can hold the key to the country's future, especially when governance is weak.

There are an estimated 2000 or so development NGOs in Bangladesh. Most are small but a few have nationwide programs, with tens of thousands of employees and multi-million dollar budgets. NGOs provide, in the main, a focused set of services including credit, health, education and sanitation. Advocacy and public awareness work are also common areas of NGO work in Bangladesh. Some NGOs have developed commercial ventures (such as mobile telephony) in order to link poor producers with input and output markets, as well as to develop a source of internally generated revenue.

Microcredit, which is the dominant NGO activity, now reaches as many as 37 per cent of all Bangladeshi households and around 60 per cent of poor households. Group-based microcredit with peer monitoring – the Grameen model – was first developed in the post-war reconstruction era of the 1970s, and went to scale in the 1990s. The rapid expansion of the microfinance sector was supported by large infusions of capital channelled by bilateral donors in the form of grants (in the early 1990s) and by concessional loans from multilaterals delivered through an apex body, Palli Karma-Sahayak Foundation (PSKF). Surveys have shown that microcredit in Bangladesh generally succeeds in reaching the poor, for whom access to

microcredit plays a key role in reducing household vulnerability to shocks. Improvements in key social indicators of wellbeing (including measures of female empowerment, children's schooling and health status) have been attributed in part to the rise of microcredit.

Other innovative experiments that were introduced and then scaled up by NGOs include the development of an informal education program to cater to poor children, particularly girls, and the use of thousands of village-based community health workers to facilitate the delivery of doorstep services, in partnership with government.

Bangladesh is still a poor country. But for a country whose government is routinely rated the most corrupt in the world, it shows surprisingly good development performance, including better social indicators than its neighbour, India (e.g. a lower fertility rate). Part of Bangladesh's success is no doubt due to the role played by NGOs, who have shown that it is possible to scale up innovative anti-poverty experiments into nationwide programs, with major impact in a matter of decades.

NGOs have not always been dominant actors in Bangladesh. They have grown rapidly over time, with support from aid agencies. Bangladesh's experience suggests that support for domestic NGOs and other non-state actors, both as alternative service providers and as demanders of good governance, should be an intrinsic part of development support especially in poorly-performing countries.

Source: 'World Bank (2005f), 'The Economics and Governance of NGOs in Bangladesh' Consultation draft

difficulties facing, donor coordination should not be underestimated, especially in fragile environments subject to rapid change. For example, it has not proved possible to complete a joint Australian-World Bank-ADB country assistance strategy for PNG. A pragmatic approach is needed. Since country-level delegation is unlikely to work for AusAID in most

countries in the Asia-Pacific region, activity-level delegation should be explored further. In turn, for this to work there needs to be greater acceptance that in co-financing arrangements the design and evaluation standards of the main aid agency should be acceptable to co-financiers, and that one activity does not need to be designed to meet the various

standards of multiple donors. It should also be noted that, with increased resources, other donors will increasingly look to Australia to take a leadership role on key issues, as they are in Indonesia following the announcement of the additional \$1 billion aid package.¹⁰⁴ AusAID has been and should continue to be pro-active in this respect, positioning itself to take on this role in relation to core interests and sectors (e.g. on legal reform in Indonesia). Australia should also be willing to delegate responsibility the other way where there is a donor with the expertise and commitment to take on this role.

At the same time as harmonising with existing donors, AusAID also needs to establish relationships with the new donors, in particular China and India, whose footprint is only likely to grow in our region in the coming years. We also recommend that AusAID build on and strengthen its engagement with the European Union – particularly with regard to its role in Australia's immediate region – and seek to engage the emerging (non-OECD DAC) donors engaged in the Pacific in order to strengthen coordination.

Recommendation 6.17 *Improve harmonisation between donors:*

- (a) *AusAID should monitor its performance against the harmonisation indicators of the Paris Declaration*
- (b) *greater use should be made of delegation arrangements, especially on a project-by-project basis, and of sectoral leadership roles*
- (c) *stronger relationships should be established with the 'new donors' particularly in the Pacific.*

LEVERAGING THE MULTILATERALS

About 20 per cent of the Australian aid budget passes through multilateral channels. The largest part of these funds (about two-thirds) goes to the International Financial Institutions (IFIs or development banks): the International Development Association (IDA) of the World Bank; and the Asian Development Fund (ADF) of the Asian Development Bank. Approximately another one-third goes to various United Nations organisations. 20 per cent of ACIAR funding is given to the international agricultural research centres.

Australia is one of the most bilateral of all the aid agencies, in that it routes a relatively small proportion of its overall funding through multilateral channels. Among DAC agencies, only the United States has a higher ratio of bilateral to total funding (85 per cent) than Australia (79 per cent). However, the fact that New Zealand has a very similar ratio to Australia (77 per cent) suggests that the heavily bilateral focus of Australia is due in large part to geography, and our desire to focus on Asia and especially the Pacific where most multilaterals are less engaged.

Supporting multilaterals is not an end in itself but makes sense when it advances Australia's development objective. Australia should be more pro-active in leveraging the multilaterals to focus on issues of core interest to Australia. This is particularly relevant to our engagement with the World Bank and ADB. We view the ADB and World Bank as Australia's key partners because of their financial weight, policy dialogue role and convening power. The recently-concluded IDA and ADF replenishment rounds resulted in a large increase in commitments of 25 per cent. With the envisaged doubling of its aid budget, we recommend that, over time, Australia should look to significantly expand its support to IDA and ADF to strengthen its influence over the respective Banks' policies and programs and in recognition of the key role the Banks play in the Asia-Pacific region.

AusAID should also work more with the IFIs in areas of mutual interest. AusAID's comparative advantages are its grant-funding, its flexibility, and its ability to work with non-state actors as well as governments. The IFIs' comparative advantages are their convening power and influence, their independence, and their technical depth. Partnerships based on these different comparative advantages should be very effective. AusAID's experience with and focus on fragile states should also lead it to get the IFIs more focused on their weaker country members. A good example of this is provided by the Pacific Trust Fund, which has played an important role in getting the World Bank more engaged in the Pacific. This increased engagement has helped tremendously, but

104 See Indonesia analytical report.

more is needed. One problem is that many Pacific island countries are reluctant or unable to borrow from the IFIs. This makes them unable to benefit from the IFIs' expertise and projects, and often leaves Australia exposed as the major or sometimes only donor. It would make sense for AusAID to 'buy in' IFI projects to the Pacific (e.g. by taking on debt-servicing costs) and facilitate greater multilateral involvement in the region. AusAID should also partner with the IFIs in East and South Asia. Experience suggests that bilateral trust funds are of considerable assistance to the IFIs in helping them respond more effectively to client countries. The linkages built, which could include secondments, will also be of benefit to AusAID. As outlined in Chapter 5, a priority area for partnership, where Australia's comparative advantages would dovetail well with the World Bank and ADB, is infrastructure.

Australia has been a long-standing supporter of UN, Commonwealth and other international development organisations. Over time this support has become more selective with funding being rebalanced to favour those organisations which include an Asia-Pacific focus and are assessed as being more relevant and effective. In some cases funding has been redirected from core to specific program support or ceased altogether. In other cases Australia has withdrawn its membership from organisations entirely.

Looking forward, selective partnerships with key multilateral organisations (other than the IFIs, addressed above) should be an important part of Australia's development strategies. We support the broad approach taken in recent years. We recommend that Australia continue to support the core multilateral agencies that serve a crucial global role, for instance the World Health Organization. Beyond that, support (including the level of that support) for multilateral agencies should be based on the following criteria: (i) their relevance to the four strategic priorities (e.g. UNICEF and the UN Population Fund (UNFPA) for children's and women's health); (ii) whether their focus includes the Asia-Pacific region; and (iii) their continued effective performance. Increased effort should be exerted to

influence the performance of those organisations which are supported towards greater effectiveness and relevance to Australia's priorities.

Humanitarian assistance is an area where partnerships with multilaterals are particularly important, including with the World Food Programme, the UN Office for the Coordination of Humanitarian Affairs and the International Committee for the Red Cross.

More strategic engagement is also recommended with the more relevant and effective of the emerging multilateral or international institutions. The Global Fund is a particular case in point. Its mandate on HIV, tuberculosis and malaria will be relevant for Australia's medium-term aid strategy. Other organisations of interest in this regard include the Global Alliance for Vaccines and Immunisation, an innovative public-private partnership addressing a core health need, and the Global Development Network, with its core mandate of strengthening policy analysis capacity in developing countries.

Finally, we recommend that the Australian Government continue to make its voice heard on multilateral reform, in particular to give the developing world, especially in Asia, greater voice in the IFIs commensurate with its greater economic power.¹⁰⁵

Recommendation 6.18 *The Australian aid program should engage more effectively with multilateral agencies by:*

- (a) *significantly expanding its support to the World Bank and the Asian Development Bank, both to core concessional funding and through a range of strategic partnerships*
- (b) *pushing for reform of the International Financial Institutions to give the developing world, particularly in Asia, greater voice*
- (c) *engaging more strategically with other relevant international organisations.*

7 Selected Country Issues

AusAID has a well-developed country strategy process by which program priorities are determined at the country level, in partnership with recipient governments and other aid agencies, and in consultation with Australian government agencies. In an overview report such as this we cannot go into a great amount of individual country detail, nor would it be appropriate. It will be up to the country programs to exercise selectivity, to weigh and adapt the proposed overall themes for the aid program, and to pursue the proposed modalities in light of their respective country circumstances.

At the same time, it would not be possible to write a report such as this without including a country focus. Indeed, the starting point of the White Paper process was geographical, with a set of four analytical papers focusing on PNG, the Pacific, Indonesia and Asia (along with the two analytical reports on HIV/AIDS and engaging the Australian community). This chapter picks up selected geographical issues which did not fit easily into the two earlier thematic chapters. It does not attempt to give a comprehensive coverage of all major country issues. Several of our earlier thematic recommendations were made specifically in relation to Asia or the Pacific. These are not repeated here.

The terms of reference for the White Paper indicated that the geographical focus of the program on the Asia–Pacific region would not change. This regional focus is long-standing, has served Australia well, and we found little support in our consultations for a change in approach. However, even accepting

this geographic focus as a given, there are nevertheless questions about how the aid budget should be allocated within the region. Moreover, the Asia–Pacific focus is not an exclusive one, especially when multilateral assistance is considered. We consider first Asia, then the Pacific and PNG, and then Africa and the Middle East.

7.A ASIA

Even if aid to Asia is increased significantly, it will remain very small relative to the size of the Asian economies. In all Asian countries, except for East Timor and perhaps Indonesia, Australian aid plays a ‘niche role.’ But the role can still be a significant one, provided that it is aligned to the central challenges facing Asia. These include sustaining growth, sharing growth and managing threats. To sustain growth, Asian countries will need to continue to advance on microeconomic reform for greater efficiency and flexibility, strengthen their market orientation, and build their human capital. They will also need to meet critical environmental challenges. To share growth, the lagging regions of Asia will need to catch up, and public action will be needed to ensure that income gains are translated into health and education gains. To manage threats, Asia will need to be alert to a range of risks, from pandemics to people smuggling. These are all themes and risks we have developed in this report. Applying the aid program to them in the vast context of Asia will not be simple, but if done properly, will reap great rewards.

INDONESIA

Australia's most important aid partner in Asia is Indonesia (with the Australia Indonesia Partnership for Reconstruction and Development (AIPRD) scaling up by a considerable amount). We endorse the main recommendations of the Indonesia analytical report, particularly as they relate to scaling up the growth agenda and the long-term grant versus loan nature of the program (see also Chapter 8). Indonesia's development challenges are long-term and large scale. Investments designed to support Indonesia becoming a stable, prosperous and democratic nation are good for poverty reduction and clearly in Australia's national interest. The AIPRD arrangement which will conclude in 2009 will need to be followed with other carefully designed programs to support Indonesia's long-term development. There are long lead times in designing effective large-scale development investments and it is therefore appropriate to start considering these now.

Recommendation 7.1 *For Indonesia:*

- (a) *maintain high levels of assistance and continue to extend support for infrastructure, basic education, rural development, and small and medium enterprise growth*
- (b) *make a timely decision on arrangements to follow the current Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) commitment in order to aid planning and program development work.*

THE PHILIPPINES

We take note of the Asia analytical report's findings that Indonesia and the Philippines have both slipped down the world competitiveness league table, and in infrastructure are ranked last and second last respectively. Both countries also face serious security challenges. We have already commented on Indonesia. We agree with the Asia analytical report's recommendation that AusAID should give much more attention to the Philippines, though how this should be done will require careful planning, given weak governance and security concerns in some parts of the Philippines. We also recommend that

AusAID devote more analytical resources to the Philippines, and intensify its research and policy dialogue. As in the case of Indonesia, Australia should work closely with the multilateral banks and other major donors, particularly the US and Japan.

Recommendation 7.2 *Expand the Australian aid program in the Philippines.*

SOUTH-EAST ASIA: LAGGING AND VULNERABLE REGIONS

Given a poverty focus, and the destabilising impact of lagging regions, it would make sense for Australia to have a special focus within South-east Asia on lagging regions, in particular on the southern Philippines and Eastern Indonesia. AusAID should aim to not only improve governance but also contribute through community-based development and the provision of basic infrastructure, perhaps using employment-intensive and public-works schemes. The Mekong region is another natural focus for the aid program. It is not a lagging region. Thailand, Vietnam and southern China are all rapidly growing, and Vietnam in particular would be a good candidate for early scaling-up on the basis of its good performance. But the Mekong region also contains vulnerable countries (Burma, Cambodia, Laos) that might benefit from approaches being adopted for fragile states. It is also a region with huge integration challenges, and Australian support for Mekong integration would fit well with the proposed theme of regional integration. Australian interventions in these regions should be in partnership with one of the multilateral banks due to the magnitude of the task at hand. East Timor's future will depend in large part on how it utilises its potential oil revenues. But aid could also play an important role if it helps promote employment and good governance.

Recommendation 7.3 *Focus on lagging and vulnerable regions in Asia:*

- (a) *adopt the southern Philippines – eastern Indonesia region, and the fast growing but vulnerable Mekong region, as focal points for the aid program*
- (b) *develop substantial programs in these regions in collaboration with the multilateral development banks.*

DEALING WITH THE GIANTS: INDIA AND CHINA

Australia is phasing out its aid to India, and is also reducing its aid to China. On the one hand, this is understandable given the growth success of these countries. On the other, these are not only both poor and large countries, but they are also of great strategic importance to Australia. The Asia analytical report argues that Australia should develop a \$1 billion ten-year ‘flagship’ development cooperation initiative for India and China, revolving around a topic of regional importance, such as clean energy or HIV/AIDS. This is an attractive idea, but may unduly narrow the scope for engagement. Instead, we suggest that in both China and India there should be a significant aid program, with the aim of engagement and sharing of experience. Put simply, India and China are too important both for Australia and for the global attack on poverty for Australia to be absent. The aid program provides a useful vehicle for mutual exchange and cooperation. This will mean maintaining rather than phasing out the aid program in China, and re-establishing a selective aid program in India. Though India requested Australia, as one of a number of smaller bilateral partners, to cease operations a couple of years ago, it is interesting that it gave an exemption to the much smaller ACIAR because of its institution-to-institution *modus operandi*. We propose Australia suggest to India re-engagement on just this basis. One important part of the re-engagement would be through scholarships targeted on areas of shared interest – scholarships to India have been all but phased out, and to China greatly reduced.

Recommendation 7.4 *Develop strategic aid programs in India and China as vehicles for mutual exchange and cooperation.*

SOUTH ASIA

Apart from India, which is dealt with above, Australia has modest programs in Sri Lanka and Bangladesh, and has recently expanded its engagement with Pakistan through a new scholarship program

and an A\$80 million contribution to the post-earthquake reconstruction effort. With Asian poverty increasingly concentrated in South Asia, and with South Asia increasingly integrated with East Asia, it is likely that the Australian aid program will continue to grow in South Asia. However, it will be important to continue to shape this engagement around specific issues to maintain selectivity.

7.B THE PACIFIC AND PNG

THE CHALLENGE OF INTEGRATION

We are deeply concerned about the future of the Pacific, in particular Melanesia and the microstates (e.g. Nauru, Kiribati and Tuvalu). While some countries are performing better than others, the Pacific analytical report’s general conclusion is that, in the absence of much better domestic government performance, the likely future for the region is a ‘deterioration of services and increasing levels of poverty.’ The report on PNG gives no greater grounds for optimism. Indeed, the HIV/AIDS crisis now ravaging PNG only adds to the sense of gloom.

We are convinced that the future of the Pacific, including PNG, lies in integration. Small states can thrive if they are integrated with the global economy. Integration will require greater openness of the Pacific Island economies to trade, investment and competition. It will also require better functioning governments, higher levels of human development, and more extensive infrastructure.¹⁰⁶ A good example of what needs to change is provided by the telecommunications sector where the Pacific Islands have simply been left behind by the mobile telecommunication revolution. They have done particularly poorly compared to the Caribbean Islands for the simple reason that the Pacific has not liberalised to allow for mobile competition. Yet the telecommunications sector is of enormous importance to remote, isolated countries such as those in the Pacific.

The theme of integration could provide a useful reference point for much of AusAID’s work in the

106 The PNG analytical report’s recommendation for a stronger focus on infrastructure, which we endorse (though not at the expense of a decline in support for health and education services), can also be understood as a means of better integrating PNG both internally and with external markets.

Pacific region. We noted earlier the disappointing record of aid in the Pacific as far as growth is concerned (section 3.C). As we have stressed throughout the report, aid is only small part of the development picture, and it would be unrealistic to assume that more aid would automatically lead to more growth. But aid can help promote integration and reform. As the Pacific analytical report argued, ‘Infrastructure support, physical and social, will help reduce costs and could be a “driver” of free markets and secure property rights.’

Our emphasis in this report on increasing support for regional governance solutions in the Pacific represents another side of the integration challenge for the region (section 5.D). The pooling of government functions will promote efficiency and also transparency in the provision of important services.

EXPANDING MIGRATION OPPORTUNITIES FOR THE PACIFIC

We turn now to another integration challenge, namely migration. The Pacific analytical report noted that ‘governments are failing to meet the aspirations of their people’ and that ‘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.’ Migration opportunities are greatly skewed in the Pacific. The Polynesian countries have long had easy access to New Zealand and US labour markets, and accordingly, enjoy very high levels of remittances, often in excess of aid. Fiji has managed to find opportunities for skilled migration. But PNG, Vanuatu and Solomon Islands all have very low rates of emigration. 1995 data showed that only 0.1 per cent of Papua New Guineans and Solomon Islanders live abroad and only 0.9 per cent of *ni-Vanuatu*. Little will have changed since then. Polynesia has done much better than Melanesia, with higher economic growth, lower population growth, better social indicators, and more social stability. This can be attributed to a number of factors, including the greater sense of nationhood and social homogeneity in Polynesia as opposed to Melanesia. Some academic commentators

also attribute Polynesia’s better performance (in substantial part) to better access to overseas labour markets, which leads to lower unemployment, higher remittances, and higher investments in education.¹⁰⁷ Worldwide, the beneficial impacts of migration – large remittance flows and the inducement to higher education investment – have also been recently analysed and emphasised, though concerns remain around the problem of ‘brain drain’.

The subject of providing more migration opportunities for the Pacific has exercised previous aid reviews, all of which (the Jackson Review of 1984, the Simons Review of 1997, and the 2003 Senate review) have recommended an expansion of migration opportunities. There are basically two ways in which this can be done. We have recommended that the aid program be used to provide skills training for Pacific Islanders to enable them to migrate to Australia and other overseas labour markets. The other approach would be to open a ‘Pacific window’ for unskilled migration, either temporary or permanent. There are several precedents for this: New Zealand has a permanent, unskilled Pacific window; and Canada has a temporary, unskilled window for Mexicans and Caribbean Islanders. We suggest that the Government should consider developing a Pacific unskilled migration window to facilitate migration, especially from Melanesia and the microstates. This would complement the recently announced skills training initiative, and help achieve more quickly the same aim of promoting migration from the Pacific Islands. Constraints on the mobility of skilled labour into the Pacific should also be addressed. We recommend that the aid program undertake further analysis and research on the relationship between migration and development, especially in the Pacific.

Migration would not be a panacea for the Pacific Islands, particularly for the larger Melanesian countries, and it would take time for its impact to be felt, especially in PNG. However, the need is urgent given rapid population growth in the Pacific and the ‘youth bulge’ some islands are experiencing (section 2.C). Worldwide, much larger countries than PNG are being sustained on the back of migration,

107 For example, Duncan and Chand (2002).

including the Philippines and Nepal. And for microstates such as Nauru, Kiribati and Tuvalu, it is highly unlikely that these economies will be viable in the absence of migration opportunities.

Recommendation 7.5 *Undertake further analysis and research on the relationship between migration and development, especially in the Pacific.*

AID TO PNG

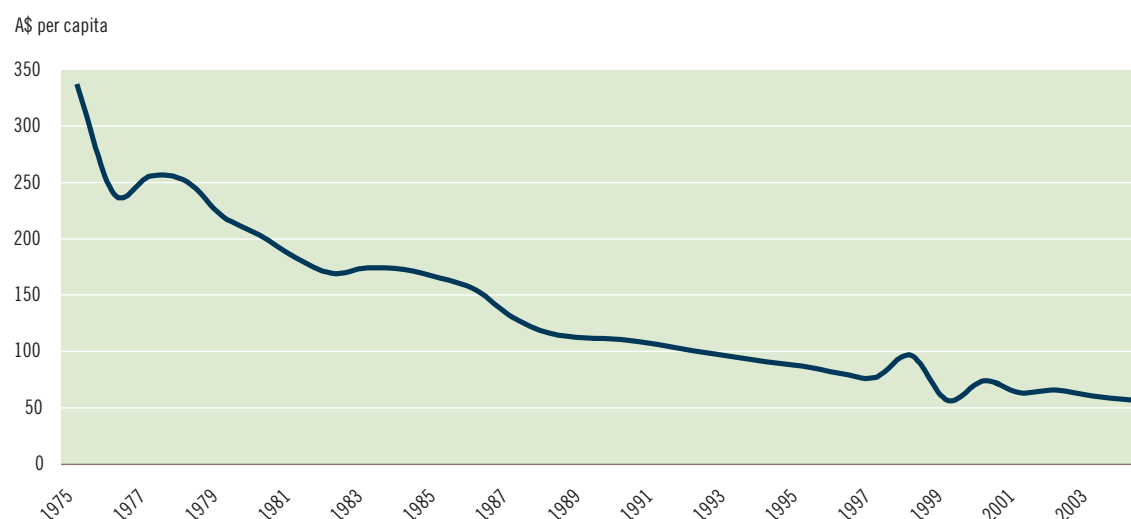
Australian governments have reduced the allocation of aid to PNG since independence as a matter of deliberate strategy. The graph below shows (in per capita terms) just how steep the decline in Australian aid has been. PNG now receives much less aid per capita than the average Pacific island state. Meanwhile HIV/AIDS is debilitating PNG. It demands a crisis response, including through treatment, which will not be cheap.

We believe there is a case for a substantial performance-based increase in the allocation of aid to PNG. Significant spending is still required on governance, and additional aid will be needed to finance the increased emphasis this report

recommends on investing in people and supporting the drivers of growth, not to mention mounting a proper response to the HIV/AIDS emergency. To ensure effectiveness, an output-based aid approach should be used to minimise the risks of wasteful expenditure, and help tie increased aid to better results.¹⁰⁸ At the macro level, a significantly increased aid budget would allow annual decisions on funding to be truly linked to a performance assessment, rather than the current situation where aid to PNG cannot be further reduced, and where there is no up-side for the country to reward it for better performance.

Australia is chasing increasingly ambitious objectives in PNG, such as a significant reduction in corruption, but with fewer resources relative to the size of PNG (economy and population). The announced large increase in the overall aid budget provides an opportunity for a new phase in the aid relationship between PNG and Australia. The risks and consequences of breakdown in PNG are too large and too real to ignore. Pro-active measures should be taken through a performance-based increase in the aid budget as well as through a significant expansion in migration opportunities, as discussed earlier.

FIGURE 7.1 AUSTRALIAN AID TO PNG (PER CAPITA) – 1975 TO 2004



Source: DAC International Development Statistics (IDS) Online; UN Statistics. Figures are in constant 2004 A\$ and are Official Development Assistance (ODA). Note: there have been increases in funding to PNG since 2004 through the Enhanced Cooperation Program.

108 It should be remembered that jointly programmed aid between Australia and PNG is still a very recent phenomenon, with budget support being finally phased out only in 2000. Much is still being learnt in terms of aid performance.

Recommendation 7.6 *The allocation of aid to PNG should increase over time, subject to agreed performance benchmarks being met.*

AID TO THE PACIFIC

In general, aid allocation to the Pacific is adequate. Indeed, the Pacific is already the most heavily aided region in the world (in per capita terms). However, some of our recommendations (e.g. greater investments in skills training, implementation of the Pacific Plan and related regional governance initiatives, and a governance incentive fund) will also need to be resourced. Australia will need to remain ready to support improvements in performance in the Pacific with additional funding, as well as to respond in the event of future instability. The Solomon Islands program is particularly expensive, with an aid per capita allocation of \$242 in 2003 (2004 prices) one of the highest in the world. This largely reflects the cost of expatriate policing. While maintaining law and order in Solomon Islands is a priority, as conditions allow, the expatriate police force should be gradually reduced, with provision for re-strengthening should law and order again deteriorate, so that these funds can be released as soon as possible for economic and social investments.

Recommendation 7.7 *Pacific aid allocations are adequate in general, but additional funding may be needed for specific high-priority initiatives.*

7.C AFRICA AND THE MIDDLE EAST

AFRICA

Australia has traditionally shied away from aid to Africa on the grounds of geographical focus and selectivity.¹⁰⁹ This appears to be widely accepted, and we did not find much support during the consultation process for more aid to Africa. At the same time, as discussed in Chapter 2, because of its lack of development progress, Africa is fast becoming the centre of global development efforts. With a large increase in Australia's aid budget, it would seem

sensible, if purely for humanitarian reasons, that Australia's support for Africa should also increase. Whether this should be done bilaterally, however, is a more difficult question. Given AusAID's capacity limits and the need for selectivity, a good case can be made that enhanced support for Africa can best be provided through an expansion of multilateral support and reliance on delegation to other bilateral donors (which we argued for in Chapter 6).

AusAID should also be interested in developments in Africa from the perspective of its focus on the Pacific Islands. These two regions have a lot in common, and greater effort should be made to share experience across the two regions on critical issues such as state fragility and HIV/AIDS. In this regard, AusAID's establishment of a Fragile States Unit, in which its support to Africa is now housed, makes a lot of sense. Australia and South Africa also have much in common. Consideration could be given to the development of common approaches and programs, for example, in Southern Africa.

MIDDLE EAST AND AFGHANISTAN

Conflict in the Middle East is of global significance and its resolution of considerable importance. Nowhere is the strong interrelationship between development and security (explored in Chapter 2) more evident than in this region. Australia's aid effort in the Middle East has consisted of ongoing humanitarian and peace-building efforts in the Palestinian Territories, and responses to conflict situations in Iraq and Afghanistan. AusAID has a strong track record of managing the aid program to ensure flexible responses to emergencies and, where required, contributions to international initiatives – the reconstruction effort in Afghanistan is a prime example of this. We believe there will be a continued need for this capacity.

109 The ODA budget for Africa is \$77 million in 2005-06.

Recommendation 7.8 For other regions:

- (a) support development and humanitarian programs in Africa largely through multilateral organisations and other bilateral donors, and ensure lessons and success-stories are shared between Africa and the Asia–Pacific region*
- (b) retain capacity within the aid program to respond to conflict situations in the Middle East and Afghanistan, and to contribute to related international initiatives.*

7.D CONCLUSION

Australia's aid program deals primarily with two very different parts of the world. In the Pacific, though some islands do much better than others, there is generally slow growth and little integration. The Pacific Islands are small and aid-dependent. Australia is a 'big player.' In Asia, growth is rapid, as is integration. Asian countries in general are large. Aid is small by comparison, and Australia a 'niche player.' For all these reasons, the ways in which the aid program is implemented in Asia and in the Pacific will have to be very different.

Australia is sometimes criticised for its focus within the Asia–Pacific region on the Pacific Islands. One document produced by the *Make Poverty History* campaign noted that 'in 2005-06, 51 per cent of the country-allocated aid is budgeted to go to the Pacific even though it contains only about three million of the 800 million very poor people in our [Asia–Pacific] region.'¹¹⁰ It has to be recognised that small island states have special needs.¹¹¹ At the same time, the announced increase in aid volumes provides an important opportunity to expand assistance to Asia, which is still very poor and of enormous strategic importance to Australia. South-east Asia is the traditional focus of Australian aid within Asia, and there is certainly scope for scaling up there, both in relation to the better performers, and to help lagging regions. While South Asian countries are also deserving in terms of poverty, and will become increasingly integrated with East Asia, more extensive engagement in these countries must be weighed against the need to maintain selectivity.

¹¹⁰ Make Poverty History Australia (2005)

¹¹¹ Target 14 of the Millennium Development Goals is to 'address the special needs of landlocked developing countries and small island states.'

8 Conclusion: Meeting the Challenge of Scaling Up

The international donor community has committed to a significant scaling up of aid resources over the next five years. Globally, aid levels will increase from US\$50 billion in the 1990s to US\$130 billion in 2010, with Australia, following the Prime Minister's announcement, set to double aid to A\$4 billion by 2010. This is an once-in-a-lifetime change. It is especially remarkable against a backdrop of stagnant and declining aid budgets worldwide in the nineties. The biggest challenge facing aid agencies will be to manage effectively this unprecedented scaling up. In this final chapter, we address this challenge, beginning with the fundamental question of whether a large increase in aid is warranted.

This question can be considered from three different perspectives: need, relative effort, and efficacy. There is no difficulty justifying a large increase in aid from the perspective of need. Despite the massive improvements in living standards in recent decades, by some estimates more than a billion people continue to survive on less than one US dollar a day. Appallingly, millions die of treatable diseases such as malaria and tuberculosis every year. In terms of relative effort, until the increases of the last few years, Australia's aid program had been roughly constant (after adjusting for inflation) over the last 20 years and thus had been declining on a per capita basis and as a percentage of income. While Australia's aid to national income ratio is around the weighted OECD average, it was also 15th out of 22 OECD countries in 2004 in relation to this ratio.

Thus, from the perspective of comparative effort as well, an increase in the aid program is justified. Whether a large aid increase is warranted thus comes down to the efficacy of aid. Put most simply, it must be the responsibility of the aid program to ensure that the efficacy of aid is sufficient to justify its proposed scaling up. This report's recommendations have been written with this in mind.

AusAID has been through a period of significant change and development in recent decades. In the 1984 Jackson Review of the aid program, the Australian Development Assistance Bureau (or ADAB as it was then called) was described as 'predominantly a clerical rather than a professional organisation'. By the time of the Simons Review in 1997, the assessment was that AusAID was 'a professional organisation dedicated to managing a complex and difficult task' but that more attention was needed, among other things, to skills development and decentralisation. Since that time AusAID has pursued these agendas, particularly through its 2001 strategic plan. Many more staff members are now in the field, systems and quality processes have been improved, and recently internal skills have been upgraded with the expansion of the advisory cadre within AusAID.

These changes mean that the agency is well placed to scale up in the coming years. Nevertheless, ensuring that an expanded budget does not mean a less efficient aid program will be a major challenge. We have already put forward a number

of recommendations (in Chapter 6) to protect and improve development effectiveness. We conclude with a number of additional suggestions which could usefully guide the scaling-up of the aid program, and help ensure maximum value for money.

Retain and build on the strengths of Australia's aid program: The aspects of 'comparative advantage' in Australia's aid program are not only its regional concentration but also its 100 per cent grant funding (excluding the recently introduced loan component of AIPRD), and its ability to fund non-state actors as well as governments, to move quickly and flexibly, and to take on issues of political as well as economic governance. None of these are strengths of the much bigger development banks. Given all this, Australia is in a strong position to be an innovator and to contribute to, as well as draw from, the global lessons of development experience. Better, more rigorous evaluation, as discussed in Chapter 6, will help in this regard.

Restrict aid to grants: Given the advantages that being a grant-funding agency provides, we would recommend against the aid program scaling up through concessional loans. Lending has been absent from the aid program since the abolition of the Development Import Finance Facility (DIFF) in 1997, but was reintroduced early in 2005 through the AIPRD. The Indonesia analytical report recommends that the experience with the AIPRD loan program be reviewed, noting that it would probably make sense in the longer term to move to an all-grant program, particularly as the Indonesian Government itself is looking to reduce its loan exposure. Globally, the rest of the aid world is moving away from lending and Australia should not move in the opposite direction.

Untie the aid program: There is widespread international acceptance of the importance of untying aid, that is, of allowing firms from all around the world to compete for aid-financed contracts. The World Bank estimates cost-savings of 15 to 30 per cent from untying. AusAID has made considerable progress in the direction of untying, and in January 2004 untied all aid to Least Developed Countries (LDCs). LDCs that are major recipients of Australian aid include Solomon Islands, Samoa and Vanuatu in the Pacific, and Bangladesh, Cambodia, and Laos in Asia. Tenders

for construction are also untied for all countries (not only LDCs), except under the AIPRD, which limits participation to Australian, New Zealand and Indonesian firms. Other forms of aid to other countries remain tied (although they are open to New Zealand and partner country national firms). Several countries have gone further than Australia in untying: the United Kingdom has completely untied all aid, for example, and very recently the European Commission (EC) has moved very far in the same direction. The EC announcement is particularly noteworthy: as well as untying aid to all Least Developed Countries, it will also untie all aid on a reciprocal basis with those donor countries whose aid programs are also untied. So, untying the Australian aid program would provide access for competitive Australian firms and individuals to a multi-billion dollar and growing market. The time for action on this is right now given the recent EC announcement, the need to demonstrate improved effectiveness and the need to draw on an expanded pool of expertise in a scaled-up aid environment. We also note that the submission from the International Development Contractors, which represent most of AusAID's development contractors, supported the full untying of Australian aid.

Avoid becoming over-ambitious, and ensure selectivity: Even when scaled up, the Australian aid program will remain a relatively small player in the aid world. The aid program as a whole needs to meet a wide range of challenges given the variety of situations within which it operates. But individual country programs need to be focused rather than spread thinly. Hard choices will need to be made. Concrete and realistic objectives will be needed for specific programs, themes and countries.

Scale up skills and resources: With increased budgets will come increased expectations for Australia to be a leader in policy dialogue. A reduced emphasis on stand-alone projects and a greater focus on working with developing partner governments will also place new demands on AusAID. Less reliance on technical assistance will make it more difficult to out-source the technical skills required to deliver aid. This report has not gone into managerial issues. However, it is clear that considerable skilling-up and greater in-depth knowledge of country policies

and circumstances will be required to meet the dual demands of an increased budget and a different way of doing business. Delivering an increased quantity and quality of aid will also require an increased departmental budget for relevant Australian government agencies.

Monitor and minimise any negative macro-level impacts of scaled-up aid: Recent research has suggested that in aid-dependent countries additional aid can have negative macro-level effects through, for example, exchange rate appreciation or negative incentive effects (Box 3.3). Many of the recommendations made in this report (e.g. to use aid to expand the productive capacity of the economy) will counter these adverse impacts, but careful monitoring will be needed, especially in the smaller Pacific states.

Sequence the scaling up: Better performers will have more capacity early-on to absorb increased amounts of aid. The earlier years of expansion might also sensibly see a focus on planning, resulting in a back-loading of the scaling-up.

Recommendation 8.1 *Australia's aid program should be completely and immediately **untied**. All future tenders should be open to bidders of all nationalities.*

Recommendation 8.2 *Provide AusAID and other relevant agencies with sufficient **resources** to scale up increased development assistance efficiently and effectively.*

8.A CONCLUSION

Australia's aid program has the important objective of serving the country's national interest by helping developing countries, especially in our region, reduce poverty. The large announced increase in the aid budget presents a real opportunity, but also a challenge. However well-performing the current program, business-as-usual is simply not an option. The aid program in five years time will inevitably be very different from the aid program of today. The recommendations in this report represent sensible ways to expand the aid budget, to protect and improve development effectiveness, and to meet the challenges of scaling up.

Expectations will need to be managed. Aid, even when scaled up, will remain a relatively minor determinant of development success. It is legitimate, however, to expect that a much larger program will be a better performing one, able to show results, and make a difference. Australian aid, if used to innovate and demonstrate new ways of doing development, can have not only a regional but also a global impact.

Attachment I

WHITE PAPER: APPROACH AND METHODOLOGY

INTRODUCTION

In 1997 the Government outlined its aid policy in *Better Aid for a Better Future*. This was subsequently updated in the Foreign Minister's 11th Statement to Parliament in September 2002, *Australian Aid: Investing in Growth, Stability and Prosperity*. Within this clear framework the Australian aid program has grown in recent years.

The program has responded to key challenges within the Asia-Pacific region (Asian financial crisis, regional security, East Timor, Bougainville, Solomon Islands, PNG, Indian Ocean tsunami) and has successfully placed a central focus on good governance.

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'.

However, the challenges to development will continue to grow, particularly in parts of South-east Asia and the Pacific. While the Australian aid program has a strong record on economic and public-sector governance and basic service delivery, which are essential to development, more needs to be done to promote stability, broad-based growth and sound political governance.

In order to ensure that Australian aid in future years continues to maintain an optimal approach and secure positive development outcomes, it is timely to seek a broad range of professional input into the development of a medium-term strategic framework for the aid program within the Asia-Pacific region.

To this end a major, collaborative exercise will bring many Australian Government and external international-development experts together, working closely with AusAID and government colleagues, in order to present recommendations to the Minister for Foreign Affairs in December 2005. The Minister will then present a White Paper to Parliament on the future directions of the aid program in early 2006.

OBJECTIVES

- > To propose a medium-term strategic blueprint for the Australian aid program in the Asia-Pacific region that builds on the significant platform already achieved and optimises the use of aid funding.
- > Within the strategic blueprint, to outline approaches to stability, broad-based growth and political governance within the Asia-Pacific region that strengthen development outcomes, noting that some approaches will be generic in nature while others will be country or region specific.

- > To recommend how the aid program can address questions regarding the investment climate in the Asia–Pacific, particularly the impact of property rights.
- > To recommend how the aid program can best establish partnerships in order to maximise the impact of Australia’s bilateral aid engagement within the Asia–Pacific region, e.g. with the private sector, international financial institutions, non-government organisations and academia.

A key principle in the development of the strategic blueprint is collaboration between external experts and stakeholders, government partners and AusAID. To this end, joint external and AusAID teams will be involved in preparation of the work, with the final report to the Minister prepared by an externally-led core group.

METHODOLOGY

The Minister for Foreign Affairs has asked that the strategic blueprint for the future directions of the aid program be centred upon country-based strategic reviews of key program directions in the context of national and regional challenges. Therefore there needs to be a primary focus on key bilateral and regional programs. For a single team to do justice to the breadth and depth of the aid program across the Pacific and Asia regions would take many months and would not be able to draw on the different expertise and experience required for each country/region.

Accordingly it is necessary to structure the process in a way to meet the following criteria:

- > Focus on the Asia–Pacific region
- > Substantive analysis on the direction of Australia’s key bilateral aid engagements
- > Contestability of ideas
- > Collaboration between external experts and AusAID expertise
- > Engagement of the Australian community
- > Focused report with clear recommendations to the Minister

- > Completion of external exercise by December 2005

The first piece of work in the process was the preparation of a paper by AusAID, approved by the Minister, that lays out the current framework of the aid program, the challenges it faces and lessons learned in recent years, and which poses a series of questions for the review teams (see the “Guidance for the Core Group” paper).

1. Core Group Report to the Minister for Foreign Affairs

A Core Group of three individuals will have overall responsibility for submitting recommendations to the Minister for Foreign Affairs in December 2005 for a strategic blueprint for the future of the Australian aid program in the Asia–Pacific region. The group will be headed by Professor Ron Duncan (Executive Director, Pacific Institute of Advanced Studies in Development and Governance at the University of the South Pacific and Emeritus Professor at the Australian National University) and will also consist of Dr. Meryl Williams (Chair of the Board of Management and President of the Policy Advisory Council of the Australian Centre for International Agricultural Research (ACIAR) and former Director General of the WorldFish Centre) and Dr. Stephen Howes (Principal Economist for the World Bank in South Asia). Dr. Howes will join AusAID as Principal Economist in July 2005.

2. Geographic Analyses

There will be four strategic analyses of key program directions in the context of national and regional challenges, one with a focus on the Pacific, a second with a focus on PNG, a third with a focus on Indonesia and a fourth with a focus on Asia. This geographic distribution reflects the current focus of the aid program and it is not the intention of this process to question current government policy in this regard. Each review will make recommendations to the Core Group on future directions for the program.

Geographic teams will consist of two individuals supported by AusAID posts. The head of each team will be an external expert with the second member being drawn from the ranks of AusAID. The teams

will be as follows:

- > Pacific: Professor Ron Duncan (University of the South Pacific) and James Gilling (AusAID Economist and Principal Governance Adviser)
- > PNG: Alan Morris (Chair, Commonwealth Grants Commission) and Robert Stewart (AusAID Economist)
- > Indonesia: Dr. Mark Baird (consultant, formerly World Bank Vice President and Country Director for Indonesia) and Peter Versegi (AusAID, Head White Paper Secretariat)
- > Asia: Dr. Ellie Wainwright (Australian Strategic Policy Institute) and Ian Anderson (AusAID Economist and Principal Design Adviser).

The teams will spend from the beginning of June to the middle of August conducting field work and seminars in the region (drawing in external expertise where warranted) and in preparing their reports. While the reports will be an important framework for the Core Group's overarching work, they will also be a resource for AusAID's geographic areas in the development of future country strategies, refining program directions, and optimising the developmental impacts of bilateral and regional aid interventions.

In some cases there is already work to build on, such as the recent joint review with the PNG Government of the aid program to PNG and the preparation by AusAID and others of Pacific 2020, a view of development in the Pacific region over the coming 10 to 15 years. The approach on Indonesia will need to be substantially informed by Australia's developing links through the Australia-Indonesia Partnership for Reconstruction and Development (AIPRD). Likewise for PNG and the Pacific, broader Australian Government policy initiatives will be clear points of reference. The review process will draw on other work, not duplicate it.

3. Thematic Reports

While the primary approach will be geographic, two specific reports will be commissioned that will also be invaluable to the aid program in and of their own right. Both reports will be prepared between June and mid-August 2005.

HIV/AIDS: The Australian Government has made a significant commitment to tackling HIV in the region, \$600 million over 10 years. It is important to back this funding commitment with generating regional political leadership and scientific rigour. To this end a report will be prepared by Professor Robert Moodie (Chief Executive Officer of the Victorian Health Promotion Foundation and formerly World Health Organization) and Annmaree O'Keeffe, the Minister for Foreign Affairs' Special Representative for HIV/AIDS. The report will draw on the research work undertaken to inform the Government's international HIV/AIDS policy and recommend how Australia can do more to prevent the spread of HIV/AIDS in the region. It will also explore how stronger partnerships can be built between governments, the business community, donors, HIV/AIDS groups and civil society. The report will highlight how to strengthen Australia's leadership in the sector and how to mainstream HIV/AIDS interventions across the aid program.

Engaging the Australian Community: The aid program has numerous partners in Australia, from the private sector to the general public, academic institutions to non-government organisations, think-tanks to the media. A report will be prepared by Gaye Hart (President of Australian Council for International Development's Executive Committee) and Ellen Shipley (AusAID NGO specialist), that will recommend how the aid program can maximise the expertise and experience offered by its various partners.

4. Consultation Period

From mid-August the Core Group will conduct a series of consultations. There will be a series of targeted seminars in state capitals around the country which will be chaired by the Parliamentary Secretary. These seminars, which will be issue-driven, will engage invited experts, commentators, journalists, NGOs, academics and the private sector. Video seminars will be conducted with international experts.

5. Reference Group

It will be important that the Core Group remain mindful of government policy and whole-of-government considerations. A Reference Group will be established that will interact with the Core Group during the report preparation process as needed. It consists of: Department of Foreign Affairs and Trade, Australian Treasury and Department of the Prime Minister and Cabinet Deputy Secretaries; the Head of ACIAR; and AusAID Executive and Principal Adviser representation.

6. Role of Aid Advisory Council

Five members of the Aid Advisory Council (AAC) are external experts in the process. It is proposed that two AAC meetings be devoted to discussing the strategic blueprint, a working session in June (early in the process) and a formal AAC meeting in November prior to the finalisation of the report.

7. Final Report

The Core Group will submit the final recommendations to the Minister by mid-December 2005.

8. White Paper

Following the Minister and Government's consideration of the recommendations, AusAID will prepare a White Paper for Ministerial presentation to Parliament in late March 2006.

ADMINISTRATION

The Core Group and all activities within the development of the blueprint will be supported by a small secretariat consisting of an AusAID Assistant Director General and research and support staff. The secretariat will be located within AusAID.

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NB: As one of the first steps in the White Paper process, a number of geographic and thematic analyses were commissioned. These background 'analytical reports', which are referenced above, are included in the companion volume of this report. The analyses were prepared by joint AusAID/external teams, and involved consultations with partner governments, other donors, academics, the private sector, community organisations and other relevant experts.

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