2015 PNG Update
Keynote address 1: ***Lessons from reform in Africa and Asia***
Jim Adams (Former Vice President for East Asia and Pacific, World Bank)

I want to begin by thanking the PNG Government, the University of Papua New Guinea and the Development Policy Centre of the ANU for the opportunity to revisit PNG and participate in this important conference. Having a regular country-driven discussion of key development issues is clearly a best practice and needs to be supported as a key input into policy decision making. I am particularly impressed by the increase in submitted work from a year ago and would emphasise that this work could provide many useful inputs into improved policy making.

In deciding what to focus on today, I believe a bit of role reversal is in order. After spending 37 years at the World Bank giving advice to governments and ministries, I felt it might be interesting to focus on the major themes I would give priority to if I was made a senior technocrat in a low-middle income developing country. Drawing on my experience in both Africa and East Asia, I propose to review three issues I feel would deserve most of my attention. Moreover, in respect to the third area – capacity and institutional development – I will discuss what I feel are the failures of the present aid system, and develop some suggestions on what I feel needs to be done to address constraints in this key area.

Not surprisingly, my first priority would be on economic reform and the need to continuously review key economic challenges. I am firmly of the view that all countries need to constantly assess the impact of global shifts and be prepared to continuously assess the impact of key developments on policy choices. Indeed, this is no longer a challenge for developing countries alone. Looking at recent EU performance, countries that have undertaken needed structural reforms over the past decade have performed far better than those which have resisted reform. The story of Germany's successful labour market reforms is well known, but Sweden is a case where the Government undertook far-ranging financial and budgetary reforms to address stagnant economic performance and it has clearly seen a positive impact on economic growth and lower inflation. After the global financial crisis, Ireland took aggressive reforms to address the collapse of its banking system – its economy is now growing at above 3.5%. This is in sharp contrast with the reluctant reforms in Greece and the resulting very weak economic performance.

Turning to developing countries and PNG specifically, I am worried that the recent resource boom related to Chinese demand has created a level of confidence in ongoing policies that is not justified. While increased resource revenues are always appreciated, the importance of sensible structural policies to longer term growth is key. Indeed, having worked on Indonesia and Nigeria during my Bank career, I was always struck by the differences in policy they each adopted after the early 1970s boom in oil prices. In Nigeria, fiscal discipline was set aside, the exchange rate allowed to strengthen, and domestic industry was protected; in Indonesia the importance of fiscal disciple was maintained, the exchange rate was carefully

managed to sustain agriculture performance, and the trade regime was far more open. The patterns of growth that followed were dramatically different. Although Nigeria began the 1970s with per capita income that was double that of Indonesia, its income fell dramatically over the 1980s and 1990s and is today approximately half that of Indonesia's.

Perhaps nothing reflects the impact of different policy choices better than what happened to the oil palm industries in Nigeria and Indonesia since the 1970s. In Nigeria, the leading global oil palm producer in the '50s and '60s, the industry has declined dramatically – today it is a marginal global producer. In Indonesia, macroeconomic, agricultural and exchange rate policies provided a stable and supportive environment for oil palm; today, combined with Malaysia, it produces 85% of global oil palm output.

The message to me is clear: policy choices do matter, even to the resource rich. It is clear to me that ensuring policies are in place in PNG to manage the emerging situation of lower resource prices will be critical to long-term growth and poverty reduction.

My second area of focus would be on private sector development. My early years in the Bank involved broad support for expanding the role of the public sector in Tanzania. The failure of that effort to generate robust growth, and the subsequent global emphasis on downsizing government and facilitating private sector led growth, has clearly marked Bank priorities and policy interests in particular during my tenure as Country Director for Indonesia. At a personal level I now recognise that there are real limits to the role of government and am convinced that in the future government will not be the major source of employment and income generation. The most effective way to do that today is clearly through facilitating a dynamic and robust private sector.

Having said this, I fully recognise that in most developing countries the private sector carries some baggage. In nearly all countries that lived through a colonial period, the private sector was closely associated with the colonial power; indeed in many instances there were formal restrictions on the involvement of local citizens in industry and commerce.

In Africa this situation was often complicated when minority groups dominated local industries by virtue of their financial capacity and business skills. In my experience I typically saw that the consequence of this history has been real doubt in recipient governments about the priority of providing an attractive business environment. When confronted with donor efforts to support private investment, I have often been amused by the disconnect between the public assurances of governments of their support for the central role of the private sector (a view they know the donors want to hear), and the very poor policy environment that exists in reality.

Yet regardless of the reservations that remain, I now feel the need to underline the fact that a more effective private sector is increasingly critical to address the massive employment and income challenges facing developing countries. In fact, on reflection, I feel this is an area I underplayed in my work on PNG and the Pacific during my tenure in the Bank – if I had to do that job again, it is an area to which I would devote far more time and attention, reflecting its importance.

Given this view, there are two specific areas which I would underline as needing more attention in government work on the private sector. The first is a tool which I think credibly assesses the real private sector policy environment at the country level, the annual *Doing Business* reports conducted by the World Bank Group. The recent 2015 report contains a comprehensive assessment of country level performance across 11 areas that can have important impacts on private sector interest and performance. Among other issues, the report assesses the cost of starting a business, the ease of dealing with construction permits, getting credit, access to electricity, etc.

Reviewing Pacific performance overall, and PNG performance specifically, is not an encouraging read. The best performing country in the Pacific is Samoa, 67th out of the 189 countries assessed; PNG ranks at 133rd. In addition, the relative performance of the region has deteriorated over time – in the 2014 ratings PNG ranked 113th of the 189 countries rated. In sharp contrast to the Pacific performance, a number of African countries and most of the countries Eastern Europe have made improved rankings on the index a focus of reform efforts: Rwanda has moved up more than 100 places over the past decade, and Georgia now ranks just behind Germany in the 20 best performers group. I would add that these countries also perform well above regional averages in recent economic growth – Rwanda grew by 6% and Georgia by 5% in 2014.

I would also note that an improved private sector environment is particularly important for the emergence of a robust domestic private sector. The simple fact is that larger and better endowed foreign actors can be discouraged by weak performance on the key areas of *Doing Business* but typically have the capacity to deal with slow and cumbersome processes and weak infrastructure; but these constraints can be devastating to a new local entrepreneur.

The second challenge is the need to more systematically develop a broader range of financing sources for private investment in the Pacific. In sharp contrast to Africa, the range of institutions involved in private sector finance in the Pacific is very limited. For Africa, nearly all European countries have established institutions that can fund private sector actors interested in investing in Africa.

Indeed I just completed a review of the Finnish aid program and even that small country supports Finnfund, a well-established financial institution devoted to supporting private sector actors in investing in developing counties, this diversity does not exist in the Pacific.

Africa is also the home of booming growth of NGO linked financing institutions. Again, this area appears much more limited in the Pacific. I would underline that I do not think the public sector can fill this gap – experience suggests that in most low income countries publically owned and operated finance companies and banks have not been effective at supporting a dynamic and effective private sector.

To summarise, my second theme is to underline the critical importance of both improving the policy environment for private sector activity, particularly for local actors, and providing appropriate incentives for the rapid growth and increased diversity of private funding sources.

My final and most detailed area of focus is capacity building. This is a longstanding aspect of development efforts that I think we can agree has not been an area of broad success. After 50 years of development support, while there are examples of dramatic improvements in institutional performance, the broad problems of weak institutions – ministries and parastatals that are not effective users of development support – is a constant refrain of project documents. Specifically, across the work I have participated in the education and health sectors in three Bank regions (Africa, Latin America and East Asia), I found the pattern of weaknesses in those key ministries has been remarkably consistent. I would underline that these ministries are both substantial users of budget resources as well as donor support; indeed in many countries the education budget is the largest single line item in the overall budget.

In addition, donor efforts at broader civil service reform have not fared well. When one reviews World Bank performance in supporting self-standing public sector reform projects, the results are not encouraging. Indeed the low success rate of Bank projects in this area has discouraged future work. More broadly I find it interesting and a bit sad that the challenge of capacity building seems to have disappeared in the reorganised World Bank – it appears nowhere in the 14 new global practices.

Further, the long-standing but more narrow investment of the Bank (and other donors) in technical assistance (TA) is often an area of frustration and criticism for recipient and donors alike. Governments often feel that TA is imposed on them by donors and that local capacity is not fully respected. They worry about the costs of foreign advisors and resent the fact that the administration of TA is typically overseen by the donor rather than by the recipient. At the same time, donors often find finalising TA contracts difficult and time-consuming, and worry that the lack of technical capacity will undermine the substantial investment of resources they are committing.

In my view this situation is particularly challenging given the key role institutions generally, and technical capacity particularly, play in ensuring sustained development impact. Indeed, when I was questioned in the Bank during my tenure as Regional Vice President of East Asia and the Pacific on what the key differences are between the successful economies in East Asia and the more challenging record in Africa, I increasingly focused on institutional capacity and the key role it plays in development performance. In particular, I would often note that while the senior technocrats and parastatal managers in East Asia and Africa typically are similarly well-qualified, in East Asia these officials were much better supported by qualified staff in lower level positions in the bureaucracy; positions that were often vacant or filled by unqualified staff in Africa.

Given this pattern of weak institutional performance, it would appear that a major rethink of how to approach capacity building would be timely and appropriate; but this hasn't happened. When I consider why, I don't have a definitive answer, but do have some tentative ideas.

My basic view is that real issue is that institutional development is simply risky and difficult. First, institutional change takes time. The typical five year length of donor investment projects may make sense for infrastructure investments, but seems very short for institutional development.

Second, sustained efforts at institutional building will have real costs for the government. Ensuring more competitive salaries and funding for training will require long-term government support.

Third, continuity of leadership and a clear strategy for institutional improvement are necessary conditions that seldom exist. Numerous donor behaviours (which I will elaborate on below) do not help the cause.

Finally, bad institutions seldom reform on their own and what I see as a broad absence of outside pressure from recipient governments and the donors to reform allows the momentum of failure to prevail.

What I propose to do is discuss key aspects of the failure of the present approaches to institutional reform and make a number of specific suggestions on how the recipient government, the donor community, or both acting in concert can increase the probability of success in this area.

First, there is no question in my mind that serious institution building requires more time to evolve than is possible in the traditional five year project. I would argue that ten years be set as a new standard for this area; this would ensure that the government involved has access to reliable long-term support.

Second, I would suggest that the government be required to have a clear, time-bound strategy for any agency being proposed for the new approach to serious institution building. It needs to own the strategy and ensure that its obligations are fully delivered. In parallel governments need to work harder to identify and support better leadership for the institutions selected for reform.

Third, the approach should preclude the typical pattern of donor fragmentation. While multiple donors might be involved, there should be only one institution building program which all donors involved would commit to. There should be a clear commitment that no funds would be provided outside the agreed program.

Moreover, any urgent TA requirements should be fully incorporated into the program. In addition, my preference would be that one donor should be assigned the coordination function. If donors aren't able to better discipline themselves, it is difficult to suggest real changes in government behaviour.

Fourth, this strategy would need to be fully funded up front by appropriate combinations of long-term government and donor funding.

Fifth, one clear source of funding are the scholarship funds available from various donors. My view is that these too should be consolidated into one program for the entity involved. Having one donor coordinate this would also make sense. I also feel that the traditional focus on technical scholarships could be made more flexible to ensure that potential institutional leaders as well as technical staff can receive scholarship support.

Sixth, I would argue for selectivity at the country level. It makes no sense to try a new approach across too many ministries and parastatals. Reforms should be focused on two or three entities that play an important role in the government's development efforts. This would also make it easier to mobilise adequate support for reform.

Seventh, in the institutions engaged in reform, all self-standing project units should be eliminated. If one is committed to the program's goal of better performance, using this long-standing substitute for effective local capacity needs to be precluded.

Eighth, poaching of key staff by donors during implementation of the institutional reform program should be strictly forbidden. While I appreciate and have supported the greater use of local professionals by the Bank and other donors, the continuity of key professional staff is central to progress and must be protected.

Ninth, I think one can make a case for the greater use of creative twinning with effective institutions from outside the recipient. The combination of a longer program and more robust resourcing makes long-term twinning a much more sensible alternative. Twinning with successful developing country capacity seems particularly attractive as they will have more recent experience with the challenges

of institutional reform. Implicitly I am suggesting that this twinning should not involve simply a 'commercial' relationship. For example, building long term relations between weak universities/ministries and parastatals, and better functioning universities/ministries and parastatals from other countries, would appear particularly attractive.

Finally, there would need to be an agreed system for regular reviews of progress in reform in the entities involved.

This is my initial suggestion list. As this is the first time I have presented such an agenda, I look forward to comments, criticisms and corrections. Given what I see as a vacuum of new approaches, I really do want to encourage innovation and creativity.

I would add that in developing this list there is one institution building program I have drawn heavily on – the IMF's work with central banks in developing countries. While I recognise that central banks have some unique advantages over other government institutions, in my view they (with IMF support) have used many of the ideas suggested above to ensure a more robust and successful program of institutional reform in the central banks they provide support to. The IMF engagement is long-term, the IMF has a clear strategy on institutional reform, they often play a central role in coordination of support and typically will provide experts from other central banks to address capacity gaps. Finally, they have a regular review process of capacity, as a key part of their supervision function.

In closing, I do have one additional suggestion for analytic work to support institution building more broadly. While the program above would focus on developing specific institutions, there is also a case for regular and serious reviews of the appropriate size of government, including a review of possibilities for privatisation as well as a regular examination of the overall structure of government and the government salary structure. We know appropriate pay is key to stronger institutional performance, and a serious and regular review of salary options can provide important insights into how to best approach this issue in the general environment of resource constraints.

Thank you for your attention; I wish you luck with this important conference.