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Cambodia

Enhancing Service Delivery through Improved Resource Allocation and Institutional Reform

Integrated Fiduciary Assessment and Public Expenditure Review

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Abbreviations and Acronyms

AC	Asphaltic Concrete	MPA	Minimum Package of Activities
ADB	Asian Development Bank	MPWT	Ministry of Public Works and Transport
ADD	Accelerated District Disbursement	MRD	Ministry of Rural Development
ADESS	Agricultural Development Support to Seila	MSF	Medicins Sans Frontiers
APIP	Agricultural Productivity Improvement Project	MTEF	Medium Term Expenditure Framework
AusAID	Australian Agency for International Development	MWVA	Ministry of Women's and Veterans' Affairs
BMC	Budget Management Center	NBC	National Bank of Cambodia
Bn	Billion	NCHADS	National Center for AIDS, Dermatology and STD Control
CAFIMEX	Cambodia Fish Import and Export Company	NGO	Non Governmental Organization
CAR	Council for Administrative Reform	NHA	National Health Accounts
CARDI	Cambodia Agricultural Research and Development Institute	NR	National Road
CDC	Council for the Development of Cambodia	NRRRP	National Road Rehabilitation and Reconstruction Program
CDRI	Cambodia Development Resource Institute	NRSC	National Road Safety Council
CENAT	National Center for Tuberculosis and Leprosy	OD	Operational District
CIF	Carriage, Insurance and Freight	OPM	Office of the Prime Minister
CMS	Central Medical Stores	PAP	Priority Action Program
CNM	Center for Entomology, Parasitology and Malaria Control	PDAFF	Provincial Department of Agriculture, Forestry and Fisheries
COM	Council of Ministers	PDB	Partnership Database
CPA	Complementary Package of Activities	PDRD	Provincial Department of Rural Development
CR	Cambodian Riel	PDWRM	Provincial Department of Water Resources and Meteorology
CSES	Cambodian Socio-Economic Survey	PER	Public Expenditure Review
Danida	Danish Agency for Development Assistance	PHD	Provincial Health Department
DBST	Double Bituminous Surface Treatment	PIP	Public Investment Program
DFID	Department of International Development	PIU	Project Implementation Unit
DHS	Demographic and Health Survey	PMU	Project Management Unit
DORD	District Office of Rural Development	PORR	Provincial Office of Rural Roads
DRR	Department of Rural Roads	PPWTD	Provincial Public Works and Transport Department
EFA	Education for All	PRASAC	Support Program for the Agricultural Sector in Cambodia
ESP	Education Strategic Plan	PRDC	Provincial Rural Development Committee
ESSP	Education Sector Support Program	PRS	Poverty Reduction Strategy
EU	European Union	PRSP	Poverty Reduction Strategy Paper
ExCom	Executive Committee of PRDC	PSP	Private Sector Participation
FAO	Food and Agricultural Organization	PT	Provincial Treasury
FBC	Finance and Banking Committee	PTTC	Primary Teacher Training College
FRMR	Fund for Repair and Maintenance of Roads	RGC	Royal Government of Cambodia
GDP	Gross Domestic Product	RRG	Rural Roads Group
GMS	Greater Mekong Sub-region	RTTC	Regional Teacher Training College
GOC	Government of Cambodia	SEDP	Socioeconomic Development Plan
ICB	International Competitive Bidding	SIDA	Sweden's International Development Agency
IFAPER	Integrated Fiduciary Assessment and Public Expenditure Review	SWAP	Sector Wide Approach
ILO	International Labor Organization	SWIM	Sector Wide Management
IMF	International Monetary Fund	TA	Technical Assistance
JFPR	Japan Fund for Poverty Reduction	TOFE	Table of State Financial Operations
JICA	Japanese International Cooperation Agency	TCAP	Technical Cooperation Assistance Program
LBAT	Labor-Based Appropriate Technology	TSS	Transport Sector Study
MAFF	Ministry of Agriculture, Forestry and Fisheries	TVET	Technical and Vocational Education and Training
MCE	Military Corps of Engineers	UN	United Nations
MEF	Ministry of Economy and Finance	UNDP	United Nations Development Program
MIA	Ministry of Internal Affairs	UNICEF	United Nations Children's Fund
MLMUPC	Ministry of Land Management, Urban Planning and Construction	USAID	United States Agency for International Development
MOC	Ministry of Commerce	VAT	Value Added Tax
MOE	Ministry of Environment	VOCs	Vehicle Operating Costs
MEF	Ministry of Economy and Finance	WB	World Bank
MOEYS	Ministry of Education, Youth and Sports	WFP	World Food Program
MOH	Ministry of Health	WHO	World Health Organization
MOI	Ministry of Interior		
MOP	Ministry of Planning		
MOU	Memorandum of Understanding		

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Cambodia: Integrated Fiduciary Assessment and Public Expenditure Review*

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* This combines the analysis of a public expenditure review (PER) and a country financial accountability assessment (CFAA). A country procurement assessment report (CPAR) has been carried out in parallel with this work.

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EXECUTIVE SUMMARY

INTRODUCTION: THE APPROACH AND ITS FINDINGS

1. Since 1999 Cambodia has made significant headway in reforming public expenditure policy and management, yet in order to implement its development agenda, Cambodia will have to make much more progress on four principal fiscal, fiduciary, and institutional challenges. First, Cambodia will have to improve resource mobilization to ensure aggregate fiscal sustainability. Second, to reduce the fiduciary risk to public funds, the Government will have to engage in comprehensive reform of budget execution, cash management, and public financial control systems. Third, the Government will have to rationalize public expenditure policy and management further to carry out both its Second Socioeconomic Development Plan (SEDP) and its National Poverty Reduction Strategy (NPRS). Last, Cambodia will have need to undertake comprehensive civil service reform—focusing on pay and employment issues—in order to deliver poverty-reducing services. The following sections elaborate on these four core challenges and provide an outline of proposed solutions. Table 1 and Box 1 summarize the approach and its principal findings.

Table 1: Key Issues in Cambodian Public Expenditure: Policies and Institutions

	Public Policy, Expenditure, and Financial Management	Civil Service Reform	Decentralization
Aggregate Fiscal Sustainability	Medium term sustainability depends on improved domestic resource mobilization and adequate, effective public sector expenditure in economic services (mainly road transport and agriculture) to finance the poverty-reduction and growth agenda.	Tight control at the aggregate fiscal level, low revenues, and expenditure policy result in a civil administration wage bill that is too low.	The decentralized communes are not yet an aggregate macro-fiscal issue, due to the Government's careful approach, but own-source revenues are a medium-long term concern.
Prioritization of Resource Allocation	Weaknesses in both the budget formulation and execution processes undermine allocative efficiency by resulting in the misallocation of resources: across and within sectors, across regions, to economic inputs, and over time.	The share of expenditure on civil administration human resources is too low, and there is room to improve the sectoral and geographic deployment of civil servants.	The allocative efficiency of provincial expenditures, in terms of targeting the poor, could be improved; the efficiency of commune spending will depend on future decisions regarding the level and mode of intergovernmental transfers.
Efficient and Effective Use of Resources for Service Delivery	Major problems in Treasury operations and cash management, and weaknesses in the control environment, impede the delivery of public resources, making the public expenditure and financial management system a source of fiduciary risk.	Excessively low wages lead to myriad dysfunctions, including corruption, and greatly undermine civil service capacity.	Progress is being made in moving service delivery closer to the poor, but much work is needed on the institutional and administrative support structure.

Box 1: The Cambodia Integrated Fiduciary Assessment and Public Expenditure Review (IFAPER)

The approach of the Cambodia Integrated Fiduciary Assessment and Public Expenditure Review (IFAPER) is fundamentally integrated and multidisciplinary in that it focuses on both policies and institutions in the delivery of poverty-reducing services. In the case of Cambodia it is clear that both the reorientation of policies as well as the reform of institutions are required to improve the impact of services provided by the public sector. Building on the World Bank's 1999 *Public Expenditure Review* and the ADB's 2001 study entitled *Enhancing Governance for Sustainable Development*, the IFAPER expanded the sectoral scope of the analysis by including other priority sectors—agriculture and road transport—in addition to education and health, and extended the institutional coverage to include the civil service and decentralization, in addition to public expenditure and financial management institutions. The augmented scope of the IFAPER is necessary in the context of the SEDP II/NPRS and for policy-based programmatic lending approaches. The approach is thus to focus on the three levels of public expenditure policy and management—*aggregate fiscal sustainability, prioritization of resource allocation, and the efficient and effective use of resources for service delivery*—in the institutional context of service delivery—*public expenditure and financial management (PEFM), civil service reform, and decentralization*. The analysis yields four principal findings:

- Resource mobilization must be improved to ensure fiscal sustainability in light of the poverty reduction and growth agenda;
- Weaknesses in the public expenditure and financial management system create unacceptably high levels of fiduciary risk to public funds;
- In order to meet the poverty reduction targets the Government will need to improve the effectiveness of public spending by more tightly linking it with priority outcomes and by reallocating resources from lower priority sectors, programs, and functions;
- Given the serious problems afflicting the civil service—low pay, low skills, and thus low capacity—comprehensive civil service reform will have to be initiated in the short term.

IMPROVING RESOURCE MOBILIZATION TO ENSURE AGGREGATE FISCAL SUSTAINABILITY

2. **Despite the need for higher revenues to finance growth and poverty reduction, Cambodia's fiscal revenue ratios, especially tax revenue, remain among the lowest in the world.** Cambodia's total revenue to GDP ratio stood at 11.7 percent in 2001, with tax revenues accounting for only 8.4 percent (see Table 2). Indeed, without significant increases in revenues, there are serious risks to both medium term macro-fiscal sustainability and the Royal Government of Cambodia's (RGC's) medium term poverty reduction program. To retain public debt sustainability and to finance higher levels of public spending, revenues will have to be greatly increased.

3. **To be sure, Cambodia has made progress since the last Public Expenditure Review in 1999.** As a result of the reform efforts, government revenue rose from 8.3 percent of GDP in 1998 to 11.7 percent in 2001, though the increase in revenue was mostly due to growth in the tax base. The replacement of the turnover tax and consumption tax on imports with a 10 percent value added tax (VAT) in 1999 also contributed to the revenue increases. At the same time, the VAT enhanced the efficiency of the tax system by simplifying the tax structure, widening coverage, and reducing cascading.

4. **It is clear that continued improvement, on the order of what has already been accomplished, is necessary.** The Government plans to raise revenues to 14 to 15 percent of GDP by 2007. Facilitating domestic resource mobilization is likely to occur through improved tax administration in the short to medium terms and improved tax policy in the medium to long terms. As tax administration reform cannot depend on civil service reform in the short term,

however, the Government should investigate options for rapid improvement through establishment of a semi-autonomous revenue authority.

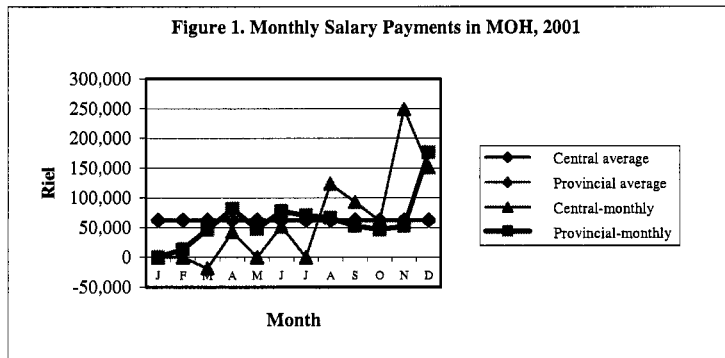
Table 2: Cambodia: Comparison of Tax Revenue Structure with other Selected Countries

	Fiscal Revenue 1/			
	Total Revenue	Tax Revenue	Direct Taxes only	Per capita GDP (US\$)
PRGF Asian countries	16.2	12.8	3.1	427
Bangladesh	8.6	7.1	1.2	370
Lao P.D.R.	11.4	9.2	2.0	310
Nepal	11.2	9.2	2.1	240
Sri Lanka	17.0	14.7	2.4	830
Vietnam	20.6	15.6	5.5	410
Mongolia	28.5	20.8	5.3	400
PRGF Sub-Saharan African Countries	17.6	13.7	3.9	323
--of which selected agricultural countries	14.4	11.4	1.8	277
Cameroon	17.8	12.2	3.3	570
Guinea Bissau	19.5	10.8	0.0	160
Mali	14.7	14.0	2.6	210
Níger	8.9	8.3	1.5	170
Tanzania	11.8	10.6	2.7	280
Togo	13.8	12.3	0.4	270
Cambodia (2001)	11.7	8.4	1.0	259

Source: IMF staff country reports.

REDUCING FIDUCIARY RISK TO PUBLIC FUNDS

5. It has become increasingly apparent that weaknesses in the public expenditure and financial management system (PEFM) not only have high costs in terms of allocative and operational efficiency but also create unacceptably high levels of fiduciary risk to public funds. The cash-based payments system has emerged as a major constraint. Increasingly, budget execution has suffered from delays and an unpredictable release of funds (even for salary payments; see Figure 1), due to cash constraints, undermining operational planning and resulting in the build-up of arrears. The system is plagued by gate-keeping and deficient accounting and reporting systems, thus leading to a weak control environment and increasing opportunities for corruption (see Box 2). Indeed, in comparative perspective, Cambodia's PEFM system ranks below average (as compared to the low income countries assessed by a joint World Bank-IMF diagnostic tool), indicating the need for substantial upgrading.



Box 2: Corruption in Cambodia: Evidence from Citizens, Firms, and Public Officials

Corruption has been repeatedly identified as a major constraint on Cambodia's development and a threat to its poverty reduction and growth agenda. A 1999 survey of citizens, firms and public officials, for example, revealed that corruption was identified by many as one of the most serious problems in Cambodia. Citizens living in rural areas identified corruption in the public sector as the second most serious problem facing Cambodia, after the high cost of living, while urban citizens thought corruption was the single most important problem. Likewise, domestic firms cited corruption as the second most important constraint on business, while 42 percent of foreign firms said corruption was the single most important obstacle for the operation and development of their business.

Source: "Cambodia Governance and Corruption Diagnosis: Evidence from Citizen, Enterprise, and Public Official Surveys," World Bank, 2000.

6. **The impact of attempts to address these problems by implementing pilot initiatives—notably the Priority Action Program—has been muted by liquidity constraints and concerns over the adequacy of control arrangements.** It is noteworthy that execution rates for the priority sectors have trailed those for the civil administration as a whole, despite the channeling of a substantial share of sector expenditures through streamlined disbursement mechanisms (see Table 3). In 2001, for example, although 92 percent of the budget provision for health was disbursed for the year as a whole, only 2 percent was disbursed in the first quarter of the year, 7 percent in the second, 11 percent in the third, and 73 percent in the last quarter. The situation in 2002 was largely unchanged, with just 8 percent in the allocation disbursed in the first quarter. The pattern in education, and indeed across Government, is much the same. These initiatives have, however, improved the alignment of resources with policy objectives and helped channel funds to operational units. If PAP, however, has failed to render significant improvement in budget execution, this is largely due to the fact that problems of cash management have persisted.

Table 3: The Back-loading Problem: Percentage of Expenditures Posted in December, 2000 and 2001

Economic/Sector	2000		2001	
	Central	Provincial	Central	Provincial
Civil Recurrent	43.4	22.8	31.6	29.9
Ch. 10: Salaries	11.6	19.4	14.1	23.7
Ch. 11: Operating Costs	38.2	25.0	42.2	34.9
Ch. 13: Specific Program Activities	47.7	100.0	47.3	70.0
Capital Domestic Financing	10.8		18.2	
Defense and Security	17.2		18.5	
Education	63.2	21.1	34.7	30.2
Health	59.7	31.7	71.4	43.6
Agriculture	41.2	18.6	30.7	28.0
Rural Development	31.5	22.1	13.2	27.4

Source: Bank estimates based on MEF TOFE.

7. **The challenge for the Government is to consolidate recent initiatives while gradually addressing the structural constraints imposed by weak financial institutions and limited capacity.** The Government will need to focus on improving budget execution, cash management, and the control environment. The analysis suggests that a gradual move toward a unified *budget execution* system is needed. An important first step will be out posting financial controllers with adequate commitment authority to line ministries. The liquidity constraints that lie at the heart of the problems of poor budget execution can be traced back to the failure of agencies to comply

with the budget law's requirements in key respects. A program of reform to strengthen *cash management* will have to focus on increased use of the banking sector, integration of local and foreign exchange operations under a unified Treasury system, improved planning and prioritization in cash management, and improved information systems for tracking commitments. Lastly, in spite of a comprehensive legal framework and a multiplicity of controls, weak financial management practices undermine transparency and accountability, posing serious fiduciary risks. For example, anecdotal evidence suggests that "facilitation" of Treasury transactions—specifically the release of budgeted funds—is common. A sound *internal and external control environment* will require not only an appropriate legal framework but also the development of an enhanced public accounting system, a culture of compliance with the law, adequate ethical and professional standards, and appropriate oversight arrangements. In this context the National Assembly should be strengthened so that it can promote greater accountability regarding the use of public funds.

RATIONALIZING PUBLIC EXPENDITURE POLICY AND MANAGEMENT

8. **Since 1998, the Government has significantly improved the alignment of resources with its developmental objectives by increasing allocations for priority sectors, notably education and health.** Government-executed spending on the priority sectors increased from 1.4 percent of GDP in 1998 to 3.2 percent in 2001. In US dollar terms, education spending has doubled from US\$ 27 million in 1998 to US\$ 56 million in 2001, with estimates indicating a further increase to US\$ 75 million in 2002. Health expenditure has nearly tripled from US\$ 11.8 million in 1998 to US\$ 34.2 million in 2001, with a further increase to US\$ 44.7 million estimated for 2002. Furthermore, the NPRS indicates that the RGC intends to continue this strategy, presenting ambitious targets for growth in priority sector spending to 2005. The reallocation to the priority sectors was financed through increased growth and revenues, and reduced expenditures in defense and security.

9. **However, to implement the SEDP II/NPRS and meet the localized Millennium Development Goals (MDGs) the Government will need to reallocate resources away from non-priority sectors and programs.** While further cost refinement is necessary, the estimate indicates that, in addition to increased revenues, official development assistance, and foreign direct investment, the Government will have to mobilize additional resources through reallocation (the preliminary cost of the NPRS action plan was estimated at US\$ 1.5 billion over the period 2003-2006). Projected growth in revenue collection will not be sufficient to finance the NPRS. Resource scarcity means that expenditure rationalization is a very high priority. Significant reallocations from low to high priority expenditures will need to occur. There are a number of possible avenues for expenditure rationalization: (a) further reduction of expenditures in the low priority sectors; (b) generation of additional savings from institutional rationalization, including consolidation of administrative structures and retrenchment; and (c) rationalization of operating expenditures by cutting administrative overhead while increasing maintenance spending.

10. **Moreover, in order to reach the stated poverty reduction goals, it is necessary to improve the effectiveness of spending by linking it more closely to priority outcomes.** Increased effectiveness can be attained by improving the pro-poor targeting of resources through more tightly linked sector plans and budgets. In education and health planning processes have improved and greater linkages between planning and budgeting have been developed, resulting in improved prioritization of spending. Agriculture and road transport have yet to make progress on this front. Table 4 provides a detailed analysis of the linkages between sector policy, expenditure, and outputs/outcomes.

Table 4: Linkages between Sector Policy, Expenditure, and Outputs/Outcomes

	Policy and Planning	Expenditure	Output/Outcome
Health	➤ The health sector has made important progress by basing its strategy on monitoring outputs and outcomes. ➤ Further work is necessary to cost and operationalize the strategy by linking it effectively to the budget.	➤ The allocative efficiency of spending could be increased (the wage share is too low and maintenance spending is inadequate). ➤ The share of spending at the provincial level is too low and the high inter-provincial variance results in inequalities in per capita spending across the country. ➤ The result is inadequate targeting of resources, which reduces the pro-poor impact of spending.	➤ There have been some significant achievements in the sector, especially regarding communicable diseases and expanded coverage of the population. ➤ However, serious problems need to be addressed, including low and uneven access to services and the inadequate pro-poor incidence of spending ➤ Service quality continues to be a concern.
Education	➤ The sector planning process is well-developed and effectively linked to the budget and nascent MTEF.	➤ There has been a significant increase in Government funding over the past few years. ➤ The major share of spending is allocated to primary education. ➤ The wage share of recurrent spending has dropped to unsustainably low levels.	➤ Steady progress has been made since 1999, in expanding educational opportunities with total enrolment growing. ➤ Enrolment growth has been concentrated among the poor. Repetition rates have also fallen. ➤ The focus on primary education means that sector spending has become increasingly pro-poor. ➤ However, net enrolment ratios and the completion rate at the primary level are the lowest in the region. ➤ Service quality continues to be a concern.
Road Transport	➤ Sector policy goals require clarification. ➤ Sector goals are not operationalized in a strategy statement, nor are they linked to the annual budget.	➤ Total expenditures have increased significantly, however allocations fall short of the amounts needed to bring the network up to a maintainable state. ➤ Routine and periodic maintenance are not funded on an on-going basis. ➤ The FRMR could, as first priority, finance routine and periodic maintenance of the currently maintainable network, plus some rehabilitation.	➤ Although a start has been made on reconstruction and rehabilitation, the state of the road network remains poor, and poor road quality, which results in high transport costs, is one of the major constraints on growth.
Agriculture	➤ Though the NPRS makes progress in sector planning, the sector still lacks a coherent pro-poor policy framework linked to the budget.	➤ The sector is under-funded. ➤ The shift from wage spending to research has reduced allocative efficiency. ➤ Sector spending is not targeted to pro-poor programs and regional departments are resource-deprived.	➤ Low levels of funding and the inefficiency of spending constrain both broad-based economic growth and poverty reduction. ➤ A lack of sector monitoring makes evaluation of impact difficult.

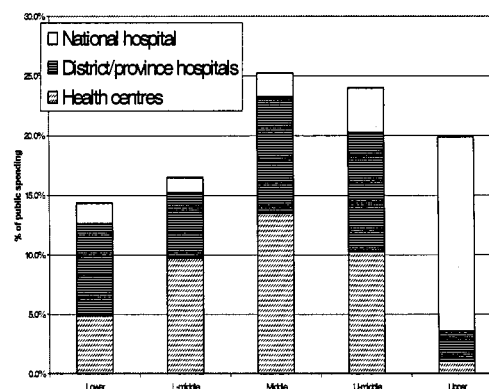
11. **Expenditures are targeted to the poor in education, but less so in health, and only marginally in agriculture.** In *education* a significantly greater amount of public spending benefits the poor in 2002 as compared with 1997 (See Table 5). In 2002, it is estimated that the poorest 40 percent of the population will receive 39 percent of total education expenditure, and 50

percent at the primary level. It is clear that increased subsidies have made education spending more pro-poor. The poorest, however, continue to benefit from only a small share of public subsidies on secondary and post-secondary education, though the poverty incidence of benefits at the lower secondary level also improved. In *health*, on the other hand, the lowest income quintile consume 13 percent of the resources, while the top quintile uses almost 20 percent (see Figure 2). This disparity is even greater if the relative health need of the poor is considered to be greater than that of the rich. Inequality in resource distribution is most evident for the national facilities. By contrast, district hospitals appear to provide the greatest benefit to the poorest group.

Table 5: Share of Education Subsidy Received by Income Quintile
(RGC Spending)

Quintile:	I	II	III	IV	V	
<i>% of Public Subsidy Using 1997 Enrolment Share</i>						
Primary	21%	21%	21%	20%	17%	100%
Lower Secondary	8%	12%	19%	23%	38%	100%
Upper Secondary	4%	4%	14%	21%	56%	100%
Post-Secondary	2%	0%	6%	15%	76%	100%
<i>Percentage of Government Subsidy Received, 2002 estimate</i>						
Total	19%	20%	19%	19%	23%	100%
Primary	25%	25%	21%	17%	12%	100%
Lower Secondary	11%	14%	19%	22%	34%	100%
Upper Secondary	7%	7%	13%	26%	46%	100%
Post-Secondary	1%	0%	12%	22%	65%	100%

Figure 2: Health Benefits Incidence Consumption Group
(RGC Spending)



12. **Problems linking policy and expenditure have resulted in significant sectoral differences in the effectiveness of expenditures in improving social welfare outcomes.** In *education* steady progress has been made since 1999, in expanding educational opportunities by growing total enrolment. However, net enrolment ratios and the completion rate at the primary level are the lowest in the region. Moreover, quality continues to be a concern. There have also been some significant achievements in the *health* sector, including a decline in the level of some communicable diseases and expansion of physical coverage of the system. However, the sector needs to improve access to services, which remains low and uneven, and rectify the imbalance in the incidence of spending. In the *roads* sector, though a start has been made on reconstruction and rehabilitation, the state of the road network remains poor. Significant increases in maintenance expenditure are required. A critical first step is to strengthen management of the Fund for the Repair and Maintenance of Roads (FRMR) by enabling it to carry out financial and performance audits of its expenditures and by requiring a formula-based maintenance expenditure program. This would ensure that expenditures from the FRMR focus on priority maintenance programs and are made according to transparent criteria. In the *agricultural* sector the lack of both clear sector policy and output information makes evaluation of impact difficult. *Gender* analysis in each of the priority sectors also shows that there are systemic barriers to service access for women and girls.

13. **Weaknesses in formal and informal accountability mechanisms have a negative impact on the efficiency and effectiveness of public sector spending, and thus on poverty reduction.** To the extent that citizens do not have effective means to express their preferences both to politicians and frontline service providers the efficiency of spending may be reduced. To the extent that citizens do not have effective means to monitor the outputs and outcomes produced by the public sector, the effectiveness of spending may be reduced. One recent positive

development in this regard is the relatively inclusive and transparent process that characterized the NPRS. Scaling up participatory mechanisms that promote inclusion and transparency would likely have significant positive effects on service delivery outcomes, thereby increasing the value for money of each riel spent.

14. **Improving the management of external assistance to ensure greater alignment with RGC priorities is also critical, given the sheer volume of external assistance in total Government expenditure.** Reported external assistance flows are significantly higher than the volume of Treasury-executed expenditures (US\$ 2,122 million) over the period 1996-2001. From 1996 to 2001, reported flows of external assistance totalled US\$ 2,672 million, of which roughly US\$ 190 million has been provided as budgetary and balance of payments support, US\$ 220 million as humanitarian assistance, and the remaining US\$ 2,264 million through projects and program activities. Although the gap between external and domestic financing is narrowing, the level of reported external assistance flows in 2001, at US\$ 472 million, still exceeded domestic revenues, at US\$ 390 million, by a significant margin.

15. **The bulk of this assistance has been channeled off-budget, both in the sense that resource allocations are not reflected in the Government's budget documents and that funds are not disbursed through Treasury.** Lack of information and the absence of effective instruments to guide the allocation of external financing seriously undermine the integrity and effectiveness of the budgetary system. At present, it is impossible to assess the impact of external project financing on overall resource allocations, let alone its implications for future patterns of on-budget expenditures, as regards provision for operation and maintenance costs for new investments. There is a considerable risk that the proliferation of donor-financed projects—by financing investments that are only tangentially related to ministries' development strategies—has led to policy drift in some instances. It is also notable that there has been a gradual shift in the functional composition of external assistance, though there is no marked trend toward the priority sectors.

16. **Improving the effectiveness of development assistance will require action by both Government and donors.** There is a growing consensus that development assistance is most effective when it is channeled to countries with good policies and effective institutions. In fact, donors, both bilateral and multilateral, are moving toward systems that allocate aid based on country performance characteristics. The World Bank's Country Policy and Institutional Assessment (CPIA) is used to allocate concessional resources to low income countries, while the US Government has recently proposed a Millennium Challenge Account (MCA) for countries that "govern justly," "invest in people," and "promote economic freedom." Cambodia could increase the effectiveness of development assistance and possibly increase total assistance by making progress on good governance and improving administrative capacity. On the donor side, greater coordination with Government and among donors is clearly needed. Donors will also be challenged to rationalize their salary supplementation practices as the Government moves forward with its civil service reform program. At the sectoral level, the solution lies in the further extension of the sector wide approach adopted in health and education and the move toward budget support once adequate fiduciary safeguards are in place. In the education sector, the creation of coordination mechanisms involving agency management and external partners has helped forge a broad consensus on policy and improve the complementarity of donor inputs.

PAY AND EMPLOYMENT REFORM IN THE CAMBODIAN CIVIL SERVICE

17. **Given the serious problems afflicting the civil service—low pay, low skills, and thus low capacity—comprehensive civil service reform will have to be accelerated in the short term and carried out over the medium term if the Government's vision of poverty reduction is to become reality.** The reform program must look at every possible avenue for *improving civil*

service pay, to attract and retain skilled staff, especially for high level management and priority sector staff; *rationalizing civil service employment*, to ensure that human resources are wisely deployed in high priority sectors; and *strengthening civil service management*, to guarantee that human resource expenditures are subject to controls (viz., on hiring and promotion) and linked more closely to the budget formulation process. Indeed, one of the principal risks to the NPRS is the capacity of the civil service to deliver. Moreover, it is clear that low public sector wages provide a breeding ground for corrupt practices. At the same time it is apparent that low pay is a leading cause of Cambodia's relatively poor standing on public sector performance. The World Bank's CPIA ranks Cambodia in the fourth lowest quintile among fellow low income countries on issues pertaining to public sector management and institutions, indicating significant room for improvement.

18. **Though the Government has recently made some progress, including an increase in average remuneration in 2002, carrying out of a civil service census, and the development of an automated payroll system, much more is required.** In some of these areas, such as workforce control, key measures such as the introduction of an establishment register will allow the Government to build productively on its previous successes, while in other areas, notably pay and employment policy, the Government will be challenged to push itself farther and faster than currently envisioned.

19. **The most pressing issue facing the Cambodian civil service is undoubtedly the low level of pay for most civil servants, in relation not only to wage levels outside the service, but also to the cost of living (see Tables 6 and 7).** Comparing the average wage to per capita GDP finds that a Cambodian civil servant only makes slightly more than the annual per capita GDP. Cambodia's ratio of the average civil service wage to per capita GDP is one of the lowest in the region. With the exception of a very limited number of high level staff (approximately 700 out of nearly 168,000 in 2003), most civil servants earn very little, in either absolute or relative terms. Moreover, the compression ratio (that is, the ratio of average pay of the highest category to the lowest category, which is under two) is very low by international standards. This will not be sufficient to attract the necessary quantity of qualified candidates to civil service positions. If the Government cannot attract qualified, experienced high and mid-level managers and professionals to spearhead program design and implementation, the RGC's ability to deliver even basic, good quality services will be impaired. Decompression of salaries coupled with average salary increases must thus become the key element of the Government's reform program.

Table 6: Median Monthly Remuneration, 2002

(US\$)			
Category	Level of Education	US\$/month	Compression Ratio
A	Secondary school + 4 years	40	1.9
B	Secondary school + 2 years	32	1.5
C	Secondary school	26	1.2
D	Other	21	--

Source: CAR.

Table 7: Private Sector Monthly Wage Data, 1999

Sector	US\$
Textiles	85.3
Hotels	63.7
Construction	68.6

Source: Cited in Abrahart (2000).

20. **There is also room to reduce the overall size of the civil service, which has been growing since the mid-1990s, and to improve its deployment to priority sectors.** According to the budget laws, public sector employment has increased by about 13 percent since 1994, from 148,353 to 167,778. The analysis suggests that: (a) reallocation of human resources to the priority sectors is warranted, given the Government's commitment to poverty reduction; (b) some compensated departure is in order both in the non-priority sectors and of lesser skilled workers; and (c) redeployment from center to province is necessary in some sectors including agriculture and health. A functional review, covering the appropriate institutional arrangements, organization, processes, and staffing of government functions in order to improve efficiency and effectiveness in service delivery, would be necessary to ascertain what the overall level of employment ought to be, where exactly the sectoral inefficiencies are, and what composition of public sector employment makes most sense for Cambodia.

CONCLUSION

21. **The challenges to Cambodia over the medium and long terms, which include both political and administrative obstacles to reform, are great, and the reform agenda is daunting.** However, Cambodia has undertaken a number of important reforms over the past several years, and reformers confronting the challenges ahead have a foundation on which to build. Since the current coalition Government assumed power in 1998 Cambodia has made important headway. Tax revenues were increased considerably in a high growth macroeconomic environment. The Government significantly improved the alignment of resources with its developmental objectives by reducing expenditure on defense and security and increasing allocations for priority sectors, notably education and health. In education and health planning processes have improved and greater linkages between planning and budgeting have been developed, resulting in improved prioritization of spending and a greater impact on poverty. The Government has also implemented important budget reforms, undertaken some measures to improve the management of the civil service, and launched a potentially important decentralization program.

22. **However, in order to carry this program forward the Government will need to speed up the pace and extend the scope of reform in four key areas.** First, Cambodia will have to increase revenue collections to ensure fiscal sustainability and to mobilize sufficient resources to fight poverty. Second, the Government will have to engage in comprehensive public expenditure and financial management reform to reduce the fiduciary risk to public funds. Third, the Government will have to rationalize public expenditure policy and management further by reallocating resources to its highest priorities and improving the efficiency and effectiveness of spending. Last, Cambodia will have need to undertake comprehensive civil service reform—focusing on pay and employment issues—in order to deliver poverty-reducing services. To be sure, some difficult decisions about resource allocation lie ahead, and in order to move forward the Government will have to deal with vested interests and other obstacles to reform. The analysis in this review aims to assist the Government in making those decisions as it goes forward in pursuit of its reform program.

23. **The priority action matrix provides an indication of the reforms already underway as well as the next steps required to enhance service delivery through improved resource allocation and institutional reform.** The matrix indicates the steps the RGC is already undertaking or has committed to with donor support, in part as a result of the dialogue that developed around the IFAPER (the matrix only addresses priority issues identified in this report and does not cite other on-going reform efforts). These actions are regarded by both the RGC and donors as among the most critical, especially in the areas of public expenditure and financial management and civil service reform. The matrix also provides a set of short and medium term

reform options that require continued discussion with Government and other stakeholders. In many of these areas, the RGC is fully aware of the steps it must take. What is required is building a coalition of central oversight agencies, line ministries, and other stakeholders, including donors, to move this important agenda forward. It is hoped that this report will assist in that process.

PRIORITY ACTION MATRIX: SUMMARY OF RECOMMENDATIONS

Issues	Reform Measures Underway (donor support in parenthesis)	Short Term Recommendations (1 year)	Medium Term Recommendations (2-3 years)
A. Increasing Domestic Resource Mobilization Despite the need for higher revenues to finance growth and poverty reduction, Cambodia's fiscal revenue ratios, especially tax revenue, remain among the lowest in the world. The Government must greatly increase revenues through tax administration and policy measures to finance higher levels of public spending.		➤ Undertake feasibility study of comprehensive tax administration reform, including analysis of revenue authority option ➤ Set timetable for automation of customs department, including selection of IT system and financing plan ➤ Increase staff working on collection enforcement and audit of taxpayers in tax department ➤ Improve enforcement of collections from delinquent taxpayers through freezing of bank accounts, impounding imports/exports, and canceling licenses ➤ Maintain the suspension of logging activity until management plans and agreements on restructured concessions are in place	➤ Improve own source revenue collections from forestry and fisheries by: ⇒ providing for initial NAA audit of collections ⇒ strengthening physical resource planning and control mechanisms ⇒ improving disclosure of plans, prices, and projections through regular public reporting ➤ Improve revenue collections from and management of other state assets, including non-forest lands, minerals, and national patrimony through better planning, control, and public reporting
B. Rationalizing Public Expenditure Policy by Increasing Allocations to Priority Sectors and Priority Spending Items The RGC will need to mobilize additional resources to finance its NPRS, even accounting for increases in revenues. Further increases in resources will have to come from the reduction of expenditure on low priority sector and items. Significant reallocations from low to high priority expenditures will need to occur across government.		➤ Review the status and definition of priority sectors and adopt a more nuanced approach that identifies priority programs at the sectoral and cross-sectoral levels ➤ Develop a plan to reduce spending on low priority sectors and incorporate into the 2004-2006 MTEF ➤ Increase the share of the civil	➤ Undertake cost-effectiveness analysis of spending on administrative overhead across the public sector ➤ Develop a plan to rationalize administrative structures in order to save resources (based on the results of the functional review) and incorporate into the 2004-2006 MTEF

Issues	Reform Measures Underway (donor support in parenthesis)	Short Term Recommendations (1 year)	Medium Term Recommendations (2-3 years)
		administration wage bill as a percentage of recurrent spending, especially in the priority sectors through targeted allowances	➤ Develop guidelines for line agencies on formulating adequate maintenance expenditure programs
C. Improving the Linkages between Policies, Expenditures, and Outcomes in the Priority Sectors The development of appropriate policy and the linking of policy to expenditures has been quite uneven across sectors, and weak linkages between policies and expenditures have resulted in major inefficiencies in the sub-sectoral composition of spending.			
In the <i>health</i> sector further work is necessary to operationalize the strategy, improve the allocative efficiency of spending, and make expenditures more pro-poor.		➤ Cost and operationalize the HSSP by linking it to the annual budget and MTEF ➤ Improve the pro-poor incidence of spending by: → revising the model that allocates funding to the provinces so that resources are more effectively targeted to provinces with worse health indicators ➤ Improve the pro-poor incidence of spending further by making greater use of equity funds to improve coverage in more remote provinces (by helping the poor obtain services in larger provincial or national facilities)	➤ Improve the pro-poor incidence of spending by: → channeling increased resources to modes of service delivery used relatively more by the poor, including health centers and clinics ➤ Increase the share of operating and maintenance expenditures devoted to maintenance, together with oversight and reporting requirements
In the <i>education</i> sector the next phase of reform should focus on further improving the allocative efficiency and management of spending as well as improving service quality.	Strengthen financial planning and expenditure monitoring capacity by issuing guidelines and defining roles and responsibilities of provincial authorities and communities for financial management, procurement and reporting procedures (<i>MOEYS with several donors</i>) ²	➤ Improve the linkages between resource allocations and strategies that have a stronger poverty reduction impact in upper secondary and tertiary education ➤ Reallocate from Chapter 11 and "other education" expenditures to high priority programs in PAP (Chapter 13)	➤ Introduce accounting standards and computerization at MOEYS and provincial levels ➤ Improve transparency by increasing public awareness of the ESSP ➤ Require full reporting of revenues collected at the school/institution level and accounting of expenditures

² Financial reporting guidelines were issued in late 2002 and a computerized financial reporting and management system was developed in late 2002 for implementation in mid 2003. See "Common Education Policy Matrix: Progress Update," draft, April 6, 2003.

Issues	Reform Measures Underway (donor support in parenthesis)	Short Term Recommendations (1 year)	Medium Term Recommendations (2-3 years)
		➤ Further strengthen financial planning and expenditure monitoring capacity for finance units in MOEYS, schools, districts, and provinces	
In <i>road transport</i> further work is necessary to clarify policy goals and operationalize a sector strategy, and to increase funding on maintenance.		➤ Clarify transport sector policy goals and operationalize them in a sector policy statement linked to the budget ➤ Develop a road maintenance program and increase sector funding for routine maintenance, together with oversight and reporting requirements ➤ Strengthen management of the Fund for the Repair and Maintenance of Roads (FRMR) by: ➔ establishing a formula-based allocation mechanism for maintenance funds ➔ providing for regular financial and performance audits of the fund and its contractors, starting with NAA in 2003 ➤ Develop a pro-poor policy framework for the sector ➤ Reallocate spending to higher priority programs/functions	➤ Increase Government funding to the sector, based on improvements in sector management (as a result of implementation of short term recommendations) ➤ Operationalize the sector strategy by developing an annual plan linked to the budget and the MTEF ➤ Review options for an appropriate governance structure for the (FRMR) and prepare follow-up action plan
In the <i>agriculture</i> sector, much work needs to be done to develop a pro-poor policy framework, link it to the budget, improve allocative efficiency, and strengthen monitoring of outputs.		➤ Develop a pro-poor policy framework for the sector ➤ Reallocate spending to higher priority programs/functions	➤ Develop a sector strategy based on the policy framework ➤ Develop a simple output monitoring and evaluation system
D. Improving Service Delivery by Strengthening Public Expenditure and Financial Management (PEFM)			
The budget structure is geared toward the financing of institutions rather than services. Increasingly, budget execution has suffered from delays and unpredictable release of funds, due to cash constraints, thus undermining operational planning. The system is plagued by gate-keeping and deficient accounting and reporting systems, leading to a weak control environment.			
Aligning resources with policies and strategies poses a major challenge for further development and implementation of the Government's National Poverty Reduction Strategy.	➤ Integrate the preparation of the medium-term civil service wage policy framework (MTWF) and the MTEF (<i>MEF and CAR with World Bank and ADB support</i>)	➤ Register government implementation agencies and recipients of external assistance in the CDC donor-financed project database ➤ Strengthen the linkage between establishment control and the annual	➤ Link the civil service establishment register to the annual budget process ➤ Provide indicative targets for external financing in MTEF for 2005 budget process

Issues	Reform Measures Underway (donor support in parenthesis)	Short Term Recommendations (1 year)	Medium Term Recommendations (2-3 years)
		➤ budget process ➤ Establish the institutional framework for preparation of the MTEF within MEF and the priority sectors	
Improving the operational efficiency of the conventional budget execution system is necessary for strengthening the overall PEFM system.	➤ Outpost financial controllers on a pilot basis from the Budget and Financial Affairs Department (BFAD) to MOH and MOEYS (MEF with IMF/ADB support through TCAP) ➤ Refine job descriptions, institutional arrangements, and authorization procedures for outposted financial controllers (MEF with IMF/ADB support through TCAP) ➤ Establish Local Budget Department with functions reassigned from BFAD (MEF with IMF/ADB support through TCAP) ➤ Post budget execution data (TOFE) on website (MEF with World Bank and SIDA support)		➤ Outpost all financial controllers ➤ Initiate revision of a budget classification system based on GFS principles
Improving the operational efficiency and compliance of the Priority Action Program execution system is necessary to improve sector performance and to strengthen oversight.		➤ Evaluate the operational efficiency, compliance, and performance of PAP by undertaking a review and tracking survey before further expansion (focusing on education, health, and agriculture) ➤ Prepare standardized financial management procedures and supporting manuals for PAP, taking account of sectoral variations ➤ Review of options for progressive computerization of PAP operations	➤ Require preparation of quarterly cash plans for PAP and introduce monthly funds release based on a quarterly allocation ➤ Define and apply readiness criteria for rolling out of PAP

Issues	Reform Measures Underway (donor support in parenthesis)	Short Term Recommendations (1 year)	Medium Term Recommendations (2-3 years)
Improving the operational efficiency and compliance in Treasury operations and cash management is the sine qua non of PEFM reform.	➤ Define and apply threshold for National and Provincial Treasury expenditure operations to be executed by check or bank transfer, and use the banking system for all intragovernmental transfers (<i>MEF with World Bank support in coordination with TCAP</i>)¹ ➤ Review requirements for computerization of National and Provincial Treasury operations (<i>MEF with World Bank support in coordination with TCAP</i>)¹	➤ Undertake an inventory of all revenue accounts ➤ Review options for execution of PAP through the banking system	➤ Based on the revenue account inventory, draw up a schedule for the elimination of revenue retention accounts that have no basis in law ➤ Integrate information on foreign exchange balances in the MEF/Treasury cash management plan ➤ Consolidate revenues into the Treasury Single Account, other than those with legal basis ➤ Require agencies to present data on approved commitments, commitments not yet cleared, and accounts payable in their monthly financial reports ➤ Review all earmarking arrangements, terminating those without basis in law or external financing agreement, and present expenditures of earmarked funds in budget documents and financial reports ➤ Implement computerization of National and Provincial Treasury operations
Improving the transparency of public accounts and financial reports is necessary for strengthening fiduciary accountability.		➤ Undertake a public expenditure tracking survey in PAP ministries ➤ Define an acceptable set of accounting policies and procedures for existing expenditure execution	➤ Prepare a simple accounting manual providing clear rules for coding of financial transactions and underlying procedures ➤ Review requirements for, design,

¹ As agreed with TCAP principals, the World Bank is taking the lead in assisting the Government in these areas (see "Strengthening Economic and Financial Management Project/Technical Cooperation Assistance Program (TCAP), Annual Progress Report, February 2002 – February 2003," Economic and Financial Policy Planning and Monitoring Unit, MEF, p. 12).

Issues	Reform Measures Underway (donor support in parenthesis)	Short Term Recommendations (1 year)	Medium Term Recommendations (2-3 years)
		➤ procedures, including PAP ➤ Prepare a modified chart of accounts covering all government financial operations	➤ and initiate implementation of a new chart of accounts reflecting appropriate standards ➤ Implement computerization of national and provincial accounting and financial reporting ➤ Require all routine management reports, trial balances, and financial reports to be computer-generated and used in decision making
Strengthening oversight arrangements is necessary to provide incentives for key reform measures.	➤ Ensure that the Government's financial statements (MEF's budget settlement accounts) are audited annually (<i>NAA with ADB support</i>)	➤ Develop and arrange financing for a medium-term capacity building program for the National Audit Authority ➤ Develop and arrange financing for a medium-term capacity building program for the National Assembly's FBC ➤ Publish the audited financial statements and make them accessible to the public	➤ Provide technical assistance to priority line ministries for the development of their internal audit capacities ➤ Review options for bottom-up accountability mechanisms in priority sectors and pilot implementation
Improving project financial management capacity at both the national and provincial government levels is necessary to for an efficient and accountable public administration.	➤ Strengthening project management capacity by developing financial management training manual, training a core group of civil servants, and developing proposals for establishing a unified PMU within the line ministries (<i>MEF with World Bank support</i>)		
E. Improving Service Delivery by Strengthening the Cambodian Civil Service Given the serious problems afflicting the civil service—low pay, low skills, and thus low capacity—comprehensive and sustainable civil service reform will have to be accelerated in the short term and carried out over the medium term if the Government's vision of poverty reduction is to become reality.	➤ Undertake the necessary analyses, including the following studies, to prepare the groundwork for an accelerated pay and employment policy (<i>CAR with World Bank</i>)	➤ Prepare a comprehensive and sustainable pay and employment policy for review and adoption by the Government	➤ Undertake a study to develop opportunities to strengthen gender equity in the civil service
A comprehensive civil service pay and employment reform program is necessary to improve administrative capacity sufficiently to meet the poverty reduction			

Issues	Reform Measures Underway (donor support in parenthesis)	Short Term Recommendations (1 year)	Medium Term Recommendations (2-3 years)
challenge.	<i>support</i>: → labor market survey, to determine the remuneration needed to be offered functional analyses → remuneration policy study to develop options to accelerate increases in remuneration and introduction of performance-based compensation → a functional review that covers the appropriate institutional arrangements, organization, processes, and staffing of government functions → employment policy study to develop proposals for redeployment and compensated retrenchment		
It is necessary to strengthen <i>civil service management</i> to guarantee that human resource expenditures are subject to controls adequate to safeguard managerial and fiduciary accountability.		➤ Develop options for improving management and control of civil service employment, including formulation of an establishment register proposal, and piloting of the proposal in select ministries ➤ Integrate the HRMIS database into the budget preparation process by providing access to MEF and (read only) access to line ministries	➤ Improve establishment control across the civil service based on fine tuning of the pilot experience ➤ Develop effective monitoring mechanisms to assess civil servants' performance and introduce disciplinary measures to promote better performance
F. Improving Service Delivery through Greater Decentralization The Government has embarked on an ambitious decentralization program to create semi-autonomous elected governments at the commune and sangkat (urban commune) level and move toward enhanced roles for provinces and municipalities as deconcentrated entities of the center.			
The Government will need to further develop the legal and institutional structure as it pertains to: the inter-governmental transfer system; revenue and expenditure management; and monitoring and evaluation systems.		➤ Operationalize the Commune Sangkat Fund Board ➤ Fix the CSF share as a percentage of resources to provide the communes some measure of resource stability ➤ Provide greater support to DOLA for	➤ Strengthen DOLA's capacity to establish a commune monitoring and evaluation system ➤ Undertake further analytical work on commune expenditure assignment and alternative commune revenue

Issues	Reform Measures Underway (donor support in parenthesis)	Short Term Recommendations (1 year)	Medium Term Recommendations (2-3 years)
		the establishment of a commune monitoring and evaluation system in order to safeguard the accountability of the decentralized system ➤ The MEF/NCSC should closely monitor the implementation of the planning, budgeting, and financial management processes with a willingness to adjust and/or simplify the systems and procedures, if necessary	bases—as inputs to the upcoming commune boundary review—before further developing the legal framework
As the RGC moves forward with decentralization to the provinces, work on a number of preparatory measures would smooth the transition.		➤ Develop a framework for decentralization based on further analytical work and clarity of reform objectives ➤ Allow sector earmarking of some provincial expenditures to improve pro-poor targeting by applying allocational formulae based on indicators of need and/or performance	➤ Undertake further work to improve the reliability of capacity building requirement costs and to determine implications for the implementation strategy ➤ Rationalize the strategy for institutional support of communes, clarifying division of labor between PRDCs and POLAs as necessary ➤ Clarify and develop a joint MRD/MOI position on the role of villages

1. THE MACRO ECONOMIC FRAMEWORK AND MEDIUM-TERM FISCAL SUSTAINABILITY: OPPORTUNITIES AND CHALLENGES FOR POVERTY REDUCTION

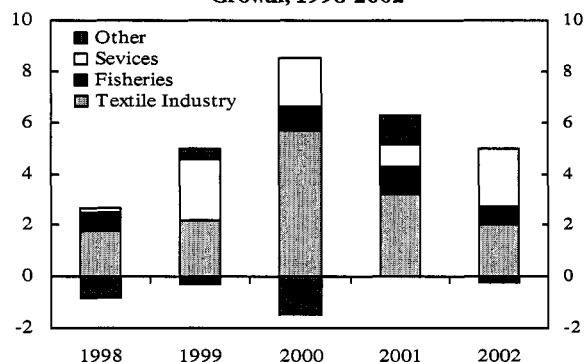
“For the RGC growth is the most powerful weapon in combating poverty and it remains committed to pursuing policies that encourage macroeconomic stability, shift resources to more efficient sectors, and integration within the global economy.”²

INTRODUCTION

1.1 Since the restoration of political stability in late 1998, Cambodia has achieved high economic growth under a conducive macroeconomic environment. Fiscal revenue has improved, stability in the inflation and exchange rates has been maintained, and the international reserve position has strengthened. Progress has also been made on the structural front, particularly regarding the completion of the bank relicensing program, strengthening of tax and customs administration, and drafting of key commercial laws needed to meet the requirements for WTO accession. The Cambodian economy, however, remains vulnerable, and the task to rebuild a country shattered by three decades of civil strife in a fragile governance environment with severe capacity constraints is daunting.³

1.2 Cambodia is well-positioned to ensure macro-fiscal sustainability over the medium term by (1) improving domestic resource mobilization to finance the growth and poverty-reduction agenda, and (2) increasing the level and effectiveness of public expenditures on economic services. In order to promote growth without reducing priority spending on the social sectors, revenues must be greatly increased to finance greater levels of public spending. Indeed, without significant increases in revenues, there are serious risks to both medium term macro-fiscal sustainability and the RGC’s medium term poverty reduction program. Greater revenues will need to be generated from tax administration as well as tax policy measures. At the same time to reduce poverty Cambodia should be targeting spending to the economic sector, which has the potential to foment and facilitate broad-based growth. Indeed, without greater investment in road transport and greater value for money from spending in the transport and agricultural sectors (to reduce transport costs and improve agricultural productivity), the ability of

Figure 1.1: Cambodia: Contributions to Real GDP Growth, 1998-2002



² “Cambodia: National Poverty Reduction Strategy,” December 2002, p. 43.

³ All GDP data in this report are based on the 2002 National Accounts (new National Accounts were released in mid-July 2003).

the economy to deliver adequate growth rates over the medium term will be weakened (current levels of expenditures and their effectiveness in these sectors is analyzed in Chapters 2 and 3, respectively). The level and effectiveness of spending on transportation will also affect the Government's ability to attract foreign-direct investment.⁴ In sum, from the macro-fiscal perspective, *Cambodia's medium term sustainability depends on improved domestic resource mobilization to finance the growth and poverty-reduction agenda and adequate, effective public sector expenditure in the economic service sectors.*

OVERVIEW OF PERFORMANCE

1.3 From 1999 to 2001, economic growth averaged 7 percent annually (4.5 percent in per capita terms) and inflation was kept below 4 percent. Despite these achievements, growth has been narrowly based, largely relying on the garment sector, which employs only a small fraction of Cambodia's population, and on tourism-related activities that are concentrated in Phnom Penh and Siem Reap.

1.4 Reform has proceeded on a number of fronts, both fiscal and macroeconomic. Between 1994-1999 a revamped budget system was put in place with donor support. Fundamental economic, fiscal, and financial rules of the game were revised with the Law on Investment in 1994, the Law on Taxation in 1997, and the Law on Corporate Accounting and Auditing in 2001. The Government has made progress in establishing an environment attractive to private investment, but further reforms are needed.

1.5 Since 1999 fiscal policy and management has been central to the reform efforts. As recommended by the World Bank's 1999 PER, and in consultation with the IMF, the critical elements of the strategy were to increase revenue to meet expenditure needs (see Annex C for a complete discussion of progress made on domestic revenue mobilization since the 1999 PER). As a result, government revenue strengthened from 8.3 percent of GDP in 1998 to 11.7 percent in 2001. The increase in revenue was mostly due to growth in the tax base. The replacement of the turnover tax and consumption tax on imports with a 10 percent value added tax (VAT) in 1999 also contributed positively to the revenue increases.⁵ At the same time, the VAT enhanced the efficiency of the tax system by simplifying the tax structure, widening the coverage, and reducing cascading.⁶

1.6 However, the likely contribution from administrative measures was negative (with the exception of 2002), strongly suggesting that administrative capacity, both in terms of systems and human resources, is acting as the binding constraint on efforts to improve revenue collection.⁷ The core concern is inadequate number of professional tax and customs collectors and the incentive structure within which they operate. There has been some limited progress in tax and customs administration with assistance from the Technical Cooperation Action Program (TCAP) adopted in May 2001. Efforts focused on ensuring a more efficient use

⁴ A sources of growth study, which will address issues of FDI, is currently under preparation.

⁵ The 1997 Law on Taxation, which began being implemented in 1999, divided the tax system into a real regime and an estimated regime. Taxpayers in the real regime are obliged to pay the VAT in lieu of the turnover tax, submit a tax declaration on profits based on their balance sheet and profit statements, and are subject to the minimum tax.

⁶ The taxable base of the VAT is much wider than the turnover and consumption tax, as it covers all incorporated businesses that are registered under the "real regime." The only exemptions are: (a) public postal services; (b) hospital and medical services; (c) public transportation; (d) insurance and financial services; (e) imports for personal use exempted from customs duties; (f) non-profit activities in the public interest, and (g) imports of goods related to diplomatic and international organizations.

⁷ Revenue from tax administration measures (TA) in time t is derived as: $TR_t = e * TR_{t-1} \Delta B - PM$; where TR is total revenue collected (actual); e measures the buoyancy of taxes and is assumed to be equal to 1; ΔB is the change in the proxy of the tax base (i.e. GDP for domestic taxes and retained imports for customs); and PM is the estimated impact of policy measures.

of pre-shipment inspection services, and increased transparency to reduce hidden costs in customs procedures. Moreover, anti-smuggling operations were strengthened through enhanced inter-agency cooperation and the establishment of anti-smuggling units in key border provinces. Improvements in tax administration during 2001-02 included enhancing collaboration among government departments and strengthening tax auditing strategies. As a result of these initial steps, collection of tax arrears has begun.

1.7 In 2002, however, revenue was expected to fall 1.25 percent of GDP below the budget target. The deteriorating performance reflected a drop in trade taxes in spite of recent efforts to strengthen customs administration, an erosion of the tax base arising from clearing the backlog of applications for tax exemptions, and the signing of contracts that reduced transfers to the RGC. In particular, the revenue potential from customs duties, which currently represents 75 percent of total tax revenue, would have been much higher in the absence of the large tax and customs duties exemptions. Indeed, on average, between 1998 and 2001 total import duties paid were almost the same as those exempted, most of which were granted under the 1994 Investment Law provisions (see Table 1.1). Many of these exemptions were for the garment industry and reflect the large quantity of imported material used by the industry. Moreover, total tax exemptions, which can also usefully be considered as tax expenditures, dwarf actual expenditures on economic services, which stood at 5.2 percent of GDP in 2001. In addition, illegal logging activity was curtailed and several forestry concessions were cancelled, reducing collections.

Figure 1.2: Cambodia Total Tax Revenue (Central Government)

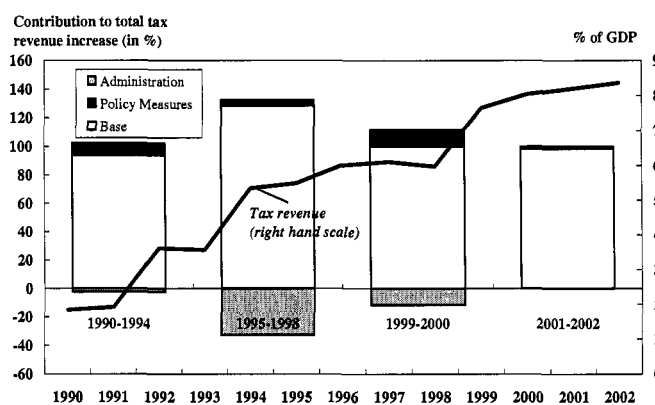


Table 1.1: Exempted Import Duties by Exemption Regime
(in % of GDP)

	1998	1999	2000	2001
Total Exempted Import Duties ^{1/}	4.7	5.2	6.3	7.3
Diplomatic missions and international organization	0.1	0.1	0.1	0.1
Investment Law provisions	3.6	3.9	4.9	5.8
International aid	0.6	0.3	0.3	0.3
NGOs	0.1	0.2	0.1	0.1
Other	0.4	0.8	0.8	0.9
Memo item	4.1	6.2	6.0	6.2
Total Import Duties ^{1/}				

Source: Data provided by the Cambodian authorities and Fund staff estimates.

1.8 With the use of traditional monetary instruments constrained by dollarization, fiscal discipline and the restructuring of the banking and payments system were key to the maintenance of monetary stability. Regained public confidence in the banking system led to financial deepening. Money velocity declined gradually, and most of the observed increase in broad money mirrored the accumulation of net foreign assets, with international reserves rising from US\$ 390 million at end-1998 to about US\$ 640 million at end-2002 (equivalent to 3.25

months of imports). Still, the use of the banking system for government transactions is very limited, and private credit remains weak. In addition, the spread between the loan and deposit rates continues to be high at around 13-14 percent, making it very costly for local firms to acquire loans (the spread is due, in part, to the cash-based nature of the economy, which results in excess liquidity).

1.9 The RGC's reform efforts have been supported by favorable external developments. Exports grew rapidly from 29 percent of GDP in 1998 to about 40 percent of GDP in 2002, and integration into the regional and world economy also intensified since 1999 when Cambodia joined the ASEAN Free Trade Area (AFTA). Export growth was driven by the garment sector, which was facilitated by the Most Favored Nation (MFN) status granted by the US in 1996 and helped to reduce the current account deficit to about 10.5 percent of GDP in 2002. Still, despite some advantages (for example, foreign investors do not need national partners, unlike in neighboring Vietnam), Cambodia's competitiveness has not improved. This reflects higher labor costs than in neighboring countries partly attributed to an erosion of competitiveness since the Asian crisis, higher operational expenses due to poor infrastructure, an uncertain business environment due to an inadequate legal and judicial system, and the low quality of public services.

MEDIUM TERM MACROECONOMIC FRAMEWORK AND FISCAL SUSTAINABILITY

1.10 Over the medium term, the Government's objective is ensure high growth and mobilize sufficient resources to guarantee fiscal sustainability. The Government intends to maintain inflation in the low single digits, while achieving an average GDP growth of 6-7 percent. The overall budget deficit (excluding grants) is expected to be reduced to about 5.5 percent of GDP and fully financed by external concessional resources. While the growth strategy calls for an increase in government revenue to 14-15 percent of GDP by 2007, the economy would also have to rely on foreign savings of about 3-4 percent of GDP with gross international reserves representing about 3.25 percent of imports of goods and services (see Table A1 in Annex A).

1.11 Output growth will require rising levels of private savings and investment and diversification of the sources of growth. Indeed, the expansion experienced in the garment and tourist sectors during 1999-2002 may not be sustainable over the medium term. The agricultural sector has the potential to play a major role through improved output in both growth and poverty reduction. Ensuring that spending in the sector is adequate (and effective) to boost production is a high priority for expenditure policy from the growth perspective. Greater access to financial services by local investors and farmers and lower intermediation costs will also be important.

1.12 Foreign direct investment (FDI), an improved investment environment, and continued donor support will be key to achieving GDP growth targets in the medium term. In the short term it will be necessary to improve road infrastructure to facilitate market access and reduce transportation costs, and to enhance port management and electricity and water connections to reduce production costs. High transport costs on the national road network are a major obstacle to increased growth. It will also be important to improve the civil service and legal and judicial system to improve governance and enhance the environment for private investment. Indeed, many consider corruption a major drag on Cambodia's development (see Box 1.1). Moreover, improving tax administration, reducing the discretionary aspects of the tax system, and adopting international accounting standards would also promote FDI. Thus, in addition to public sector reforms, greater public expenditure and greater effectiveness in spending in the economic sector, principally agriculture and road transport, must be key elements of any growth strategy.

Box 1.1: Corruption in Cambodia: Evidence from Citizens, Firms, and Public Officials

Recent empirical work suggests “a strong positive causal relationship from improved governance to better development outcomes (Kaufman, Kraay, and Zoido-Lobaton, 1999: 15).” Corruption has been repeatedly identified as a major constraint on Cambodia’s development and a threat to its poverty reduction and growth agenda. A 1999 survey of citizens, firms, and public officials, for example, revealed that corruption was identified by many as one of the most serious problems in Cambodia. Citizens living in rural areas identified corruption in the public sector as the second most serious problem facing Cambodia, after the high cost of living, while urban citizens thought corruption was the most important problem. Likewise, domestic firms cited corruption as the second most important constraint on business, while 42 percent of foreign firms said corruption was the single most important obstacle for the operation and development of their businesses.

One of the most widespread manifestations of corruption in Cambodia is unofficial payments, or bribes, to public officials. Illicit payments are often required to get public officials either to do their jobs or to provide special benefits to the payer. Rural households, urban households, and foreign firms reported having to pay bribes for public services in 43 percent, 53 percent 68 percent of their encounters, respectively, with public officials. Moreover, the survey found that bribes are regressive and thus disproportionately affect the poor, further increasing the cost of service delivery and decreasing demand for public services from the poor. In comparison to the frequency of bribe-paying by firms in other countries, Cambodia ranks in the bottom quintile, suggesting the gravity of the problem.

The literature on corruption argues that its impact on development is manifested through lower economic growth and reduced efficacy of public services. Given Cambodia’s situation, the survey data suggest that Cambodia can ill afford the negative economic and administrative externalities associated with corruption, though two-thirds of survey respondents reported in 1999 that corruption was “much worse” as compared with three years ago. Reducing corruption could yield significant economic and poverty-reducing benefits, but a lack of progress on this front only compounds Cambodia’s already difficult development challenge.

Source: “Cambodia Governance and Corruption Diagnostic: Evidence from Citizen, Enterprise, and Public Official Surveys,” World Bank, 2000.

1.13 Despite significant progress achieved in the last 4 years, Cambodia’s fiscal revenue ratios, especially tax revenue, remain among the lowest in the world. To maintain a sustainable fiscal framework, the RGC intends to increase revenues to about 14.5 percent of GDP by 2007. Such an increase would be the minimum necessary for meeting the expenditure needs underlying the current development strategy, including higher debt service payments arising from the expected completion of external debt rescheduling agreements with the US and the Russian Federation, though it would not allow for increased expenditures on economic services beyond current plans.⁸ This strategy would enable the RGC to maintain a current budget surplus of about 1 to 1.5 percent of GDP over the medium term, with an overall deficit (excluding grants) declining over time and financed by external concessional resources.

1.14 The anticipated cumulative increase of two percentage points of GDP in fiscal revenue over the medium term is based on containing further erosion of the revenue base and strengthening administrative capacity. Broadening the tax base is expected to focus on tightening and avoiding *ad hoc* tax and duty exemptions. In this regard, a simple and transparent investment regime with lower tax rates (as compared with regional competitors) could be more attractive to potential investors than a system that provides for large exemptions. On the administrative side, efforts are expected to focus on addressing staff integrity, improving procedures and the information system, and strengthening collection enforcement. The automation of customs procedures over the medium term is expected to improve capacity and to

⁸ Interest payments and amortization figures will vary depending on assumptions made on the consolidation period, and/or treatment of the pre- and post-cut-off date for Russian debt. Figures are based on Scenario A, presented in: Adachi, M. (2002), “Cambodia—Outstanding External Debt and Rescheduling Scenarios”, IMF Staff Report, EBS/02/13.

reduce hidden costs. On tax administration, collection of tax arrears is expected to be stepped-up through several enforcement measures, including freezing bank accounts. Given the urgent need to increase revenue collections, even beyond current plans, a more comprehensive reform model, such as a semi-autonomous revenue authority, merits serious attention (see Box 1.2). Otherwise, the Government might find itself in a conundrum, given that civil service reform is necessary for improving tax administration, yet improved revenue performance is necessary for carrying out civil service reform (see Chapter 5). Moreover, experience in the health sector (see Box 5.3) shows that paying higher salaries and improving management can have powerful impacts on performance, and the decision to grant the National Audit Authority autonomy to develop its own salary scale provides a precedent for autonomization under the right circumstances. The Government should review the possibility of adopting the revenue authority model for Cambodia.

Table 1.2: Cambodia: Comparison of Tax Revenue Structure with Other Selected Countries

	Fiscal Revenue ^{1/}						Per capita GDP (US\$)
	Tax Revenue					Other revenue ^{2/}	
	Total Revenue	Total	Of which				
			Direct taxes	Indirect taxes	Trade taxes		
(In percent of GDP: unless otherwise noted)							
PRGF Asian countries	16.2	12.8	3.1	7.3	2.3	3.8	427
Bangladesh	8.6	7.1	1.2	5.8	2.0	1.5	370
Lao P.D.R.	11.4	9.2	2.0	3.8	1.0	4.6	310
Nepal	11.2	9.2	2.1	4.1	3.0	2.0	240
Sri Lanka	17.0	14.7	2.4	10.2	2.1	2.3	830
Vietnam	20.6	15.6	5.5	6.3	3.4	5.0	410
Mongolia ^{3/}	28.5	20.8	5.3	13.4	2.1	7.7	400
PRGF Sub-Saharan African Countries	17.6	13.7	3.9	5.5	4.6	2.0	323
of which: selected agriculture countries	14.4	11.4	1.8	3.8	3.3	2.1	277
Cameroon	17.8	12.2	3.3	6.5	2.5	0.7	570
Guinea Bissau	19.5	10.8	0.0	0.0	0.0	8.7	160
Mali	14.7	14.0	2.6	5.0	5.4	0.7	210
Níger	8.9	8.3	1.5	1.9	4.4	0.6	170
Tanzania	11.8	10.6	2.7	6.7	1.2	1.2	280
Togo	13.8	12.3	0.4	2.8	6.1	0.8	270
Cambodia in (2001)	11.7	8.4	1.0	4.6	2.8	3.3	259

Source: IMF staff country reports.

^{1/} Data refer to average of 1999-2001

^{2/} Includes nontax and capital revenue

^{3/} Other revenues includes only nontax

1.15 Greater transparency over the terms governing the use of state assets will also be necessary to boost revenues. To improve transparency, all future contracts involving state assets are expected to be reviewed by the MEF and approved by the minister. This measure could also

help offset future declines in some non-tax revenue items. Indeed, revenue from the auction of garment quotas would end if the quota system is phased out after 2004, as scheduled; and export licensing requirements could eventually be eliminated. Nonetheless, non-tax collections are expected to be maintained at their current levels over the medium term. Revenue from forestry could increase once a forestry concession system based on sustainable practice is established (see Box 1.3), and, if the number of foreign visitors continues to increase, tourism-related revenue would rise in tandem. In addition, revenue from leases is slated to increase owing to the improved monitoring of the use of state assets and the inventory of states assets underway

Box 1.2: Revamping Fiscal Bureaucracy: The Semi-Autonomous Revenue Authority Model in Developing Countries

During the past decade or so diverse countries in urgent fiscal straits have turned to radical reform in order to improve the way their fiscal bureaucracies conduct one of the most pressing national tasks: the collection of taxes. The semi-autonomous revenue authority (ARA) reform, an early version of which originated in the developing world in Bolivia and Ghana in the late 1980s, has now been adopted by more than fifteen countries, including Malaysia, New Zealand, Singapore, Ghana, Kenya, Malawi, Rwanda, South Africa, Tanzania, Uganda, Zambia, Bolivia, Guatemala, Guyana, Mexico, Peru, and Venezuela. The pattern in each of these countries is that traditional line departments (income tax, value-added tax, and sometimes customs) are separated from the ministry of finance and granted the legal status of semi-autonomous authorities. The success of the first wave of reforms, in which the ARA model, bolstered by good tax policy reforms, boosted revenues significantly and improved service delivery, has encouraged imitation.

ARAs are defined as tax administrations that have greater than typical autonomy along several organizational design dimensions, including legal character, corporate governance, financing and budgeting, personnel policy, procurement policy, and accountability relationships. Some specific autonomy-enhancing features include self-financing mechanisms, boards of directors with high ranking public and private sector representatives, and *sui generis* personnel systems authorized to pay the salaries necessary to attract professional accountants and tax lawyers. The board of directors model promises benefits in terms of agency management and accountability. Boards, if properly designed, can play an important role in advising the revenue authority on key issues such as personnel policy and overall business strategy. Boards can also insulate ARAs from political pressure and can serve as a check on their autonomy.

The record of ARAs in Latin America, Asia, and Africa demonstrates that the ARA model permits managers to take greater control over their organizations and manage them more effectively. ARA managers have repeatedly stressed the importance of being able to make decisions more quickly and manage their organizations more responsively as a result of their autonomy. For instance, some ARA managers report that their autonomy has enabled them to pay attractive salaries and take more effective control over personnel management by confidently resisting pressure to make staff decisions based on political calculations. Autonomy has also enhanced the effectiveness of other reforms, such as large taxpayers departments.

Source: Taliercio (2003).

1.16 The success of the medium term fiscal strategy thus faces several serious risks. First, a slowdown in the world economy could reduce the number of foreign visitors dampening tourism-related activities and reducing foreign exchange earnings. Second, failure to create a predictable business environment will continue to discourage new investments in a context where the scheduled elimination of the US textile and apparel quotas on all WTO members in 2005 could lead to a sharp drop in Cambodia's exports. Third, inadequate and inefficient spending on agriculture and road transport in the medium term would undermine long term growth. Fourth, the eventual rescheduling of external debt agreements will increase fiscal pressure by resulting in higher debt service obligations, making increased revenues even more important. Failure to increase revenue to adequate levels would thus imply either cuts in government expenditure or recourse to domestic bank financing. Cutting government expenditures would constrain social spending, civil service wages, and non-wage current spending, further exacerbating the low

quality of public services. Recourse to domestic bank financing could lead to inflation, worsening income inequality, and could weaken confidence in financial institutions, reversing recent financial deepening and exchange rate instability.

Box 1.3: Fiscal Issues in Natural Resource Management

The overall scarcity of resources is compounded by under-collection and under-reporting of own source revenues (OSRs) in the natural resources sector. Table 1.3 shows that only 52 percent of total estimated revenues, as forecast in the budget law, were collected in 2001. Revenue estimates are also thought to be under-estimated. The fees generated by fishing lot owners (through sub-leasing) may be five times higher than the formal payment made for the lot.¹ The public revenue performance of Cambodia's forestry sector has also been quite poor. Over the last decade, forest revenues have seldom exceeded US\$ 10 million per year and in 2001 were only US\$ 7.7 million (in 2002 revenues from forestry concessions were insignificant as operations were suspended). In contrast, in 1996 the World Bank estimated that forestry could sustainably generate as much as US\$ 100 million annually in royalty revenues. Given current prices and quantities, however, it is unlikely that revenues will rise to this level.

Table 1.3: MAFF Revenue Collections: Estimated and Actual, 2001-2002

(Bn CR)						
	2001			2002 a/		
	<i>Estimated</i>	<i>Actual</i>	<i>%</i>	<i>Estimated</i>	<i>Actual</i>	<i>%</i>
Forestry	56,270	28,550	51%	53,113	1,534	3%
Fisheries	12,475	5,660	45%	9,887	10,508	106%
Others	1,435	2,300	160%	1,345	678	50%
Total	70,180	36,510	52%	64,345	12,720	20%

Source: MAFF.

a/ Provisional data for 2002.

Several factors drive poor revenue performance. While the RGC has made some limited advances in controlling illegal logging, there has been a substantial, but as yet unquantified, erosion in the sustainable potential harvest. Beyond this fundamental issue, policy and administrative weaknesses depress the revenue performance of the sector. The most important is the failure of the physical resource management system to deliver sustainable operations. In 2002 and 2003, the failure of concessionaires to present satisfactory forest management plans has meant that logging has been effectively suspended. Facilitation fees, "friendship" money, and other corrupt and illicit payments are encouraged by the absence of tight physical controls and transparency in resource management. These charges can amount to US\$ 30 per cubic meter or more.

Deficiencies in revenue management account for a substantial share of revenue shortfall. Under Cambodian law, forestry revenues should be transferred in their entirety to the National Treasury (NT) after collection by the Department of Forestry and Wildlife (DFW). As revealed by the 2002 MEF audit, "offsetting" transactions have been authorized whereby forest revenues are diverted to both legitimate and fraudulent claims against Government.

CONCLUSION

1.17 The challenging economic times ahead mean that the Government should focus on: (a) strengthening its revenue-raising institutions and (b) improving the prospects for long term growth and poverty reduction by investing effectively in the economic service sectors and improving the investment climate. Greater revenues are likely to come from improved tax administration in the short term and improved tax policy in the medium term. At the same time, having recently undertaken significant reallocations to the social sectors, the Government must now turn to improving outcomes in economic services—namely, reducing transport costs and increasing agricultural productivity—to promote growth and poverty-reduction (Chapter 2), and improving the efficiency and effectiveness of spending in those sectors (Chapter 3). Moreover,

improving the investment climate will require a stronger public sector characterized by less corruption and greater capacity to delivery high quality public services (Chapters 4-6).

2. RESOURCE ALLOCATION: TRENDS, OPPORTUNITIES, AND CHALLENGES

*“Cambodia has therefore rigorously embarked on expenditure rationalization. The thrust of this policy is to implement a ‘New Social Policy Agenda’ for Cambodia. The thrust of this social policy agenda is that growth must take a pro-poor path. Having implemented this ‘New Social Policy Agenda’ for Cambodia, the RGC has increased budget allocations for the priority sectors such as education, health, agriculture and rural development, which are the foundations of future growth, equity and progress.”*⁹

INTRODUCTION

2.1 Since 1998, Government has sought to improve the alignment of resources with its developmental objectives by reducing expenditure on defense and security and increasing allocations for priority sectors, notably education and health. Thus far the impressive shift in the functional and institutional composition of Government spending since the mid-1990s toward the priority social sectors has been achieved by allocating additional resources mobilized by Government and, to a lesser extent, by cutting allocations to lower-priority sectors. The National Poverty Reduction Strategy (NPRS) indicates that the Government intends to continue this strategy, presenting ambitious targets for growth in priority sector spending to 2005.

2.2 Going forward, however, it is clear that additional resources mobilized will not be sufficient to finance the poverty reduction strategy, which means that reallocations from low priority and inefficient expenditures will be necessary. Additional resources will be needed not only in health and education, but also in other priority sectors. Moreover, if the Government is to allocate greater resources to other critical functions, such as the judiciary and road transport, there is an even stronger case for further cutting base expenditures in low priority sectors. In addition to further reduction of expenditures in the low priority sectors, additional savings can be generated from: (a) institutional rationalization (this is possible because Government-executed spending on general administrative functions has increased from 1.9 percent of GDP in 1998 to 3.1 percent of GDP in 2001), including possible retrenchment; and (b) rationalization of operating expenditures through reductions in administrative overhead and increased maintenance spending.

TRENDS IN THE FUNCTIONAL COMPOSITION OF SPENDING

2.3 Broadly defined, the overall level of public expenditure has increased from 23 percent of GDP in 1998 to just over 25 percent in 2001. The broad definition comprises external assistance to projects, humanitarian aid, and Treasury-executed expenditures (see Table 2.1). Reported external financing accounted for 49 percent of total expenditures in 2001. Although this data should be interpreted with caution, owing to shortcomings in the coverage and classification of the available data on external assistance, it does provide a more accurate picture of the volume of resources consumed in the delivery of services than is gained from using

⁹ “Cambodia: National Poverty Reduction Strategy,” December 2002, p. 133.

Government expenditures alone.¹⁰ This is a much higher level of public expenditure than found in the region and other low income countries (see Annex A Table A.2). Obviously, international comparisons are much less favorable when only Government expenditures are considered.

Table 2.1: Government and Externally Financed Expenditure by Summary Function, 1996 to 2001
(% GDP)

Summary Function	1996	1997	1998	1999	2000	2001
Core Government	9.5	9.2	9.4	6.8	8.0	7.6
Economic Services	6.4	4.7	4.5	4.5	4.9	5.2
Agriculture	2.3	0.8	0.6	1.0	1.6	1.5
Transport	2.2	1.6	1.7	1.3	2.0	2.6
Other Economic Services	1.8	2.1	2.1	2.1	1.2	1.0
Environmental Protection	0.1	0.2	0.1	0.1	0.1	0.1
Rural Development	2.5	2.2	2.1	1.9	2.1	2.0
Social Services	5.2	5.4	6.8	6.9	7.2	8.9
Health	1.9	1.6	2.5	3.1	2.8	2.9
Education	2.1	2.5	2.8	2.4	2.5	3.0
Community & Social Services	1.3	1.2	1.6	1.3	2.0	3.0
Humanitarian Aid & Relief	0.4	0.5	0.3	1.4	2.0	1.2
Other	0.7	0.1	0.2	0.4	0.3	0.3
Total	24.8	22.2	23.4	21.9	24.6	25.3
Of which Treasury-Executed	10.8	10.2	9.3	10.6	11.8	12.8

Source: Bank estimates based on CDC Database and MEF TOFE.

2.4 External financing will remain critical for investment in infrastructure and capacity building well into the future. However, over the medium term, the resources needed to finance improved service delivery for poverty reduction will have to be mobilized through the Government's budget, primarily from domestic sources. The remainder of this section examines how the Government has mobilized additional resources for priority poverty reduction sectors in recent years and options for reallocation over the medium term.

2.5 There has been a significant shift in the functional and institutional composition of Government spending since the mid-1990s, particularly since 1998. This has been achieved by allocating additional resources mobilized by Government and, to a lesser extent, by cutting allocations to lower-priority sectors. Treasury-executed expenditures¹¹ increased from 9.3 percent of GDP in 1998 to 12.8 percent in 2001—a 54 percent increase in dollar terms, from US\$ 283 million to US\$ 435 million. Comparing institutional allocations in 1998 and 2001, net allocations increased by just over US\$ 140 million, while a further US\$ 32 million was mobilized by cutting expenditures in five of the thirty-three agencies (see Table 2.2). Cuts in low priority sectors assume greater importance as a source of financing year-on-year. Nevertheless, it is clear that increases in the budget base have driven expenditure restructuring in recent years.

2.6 The RGC's strategy for financing expansion of sectoral allocations for priority poverty reduction sectors is similarly predicated on the mobilization of additional resources from economic growth and improved fiscal performance. Domestically financed expenditures are programmed to increase from 12.8 percent of GDP in 2001 to 14.3 percent of GDP in 2005. Reallocations are to be made incrementally from additional resources rather than by restructuring institutions' base expenditures. Expenditures in low priority sectors such as defense and security and general administration are programmed to decline as a share of GDP, but will stabilize in nominal terms. This raises two concerns. First, the scope for resource reallocation to the priority

¹⁰ It should also be noted that there are concerns about the reliability of Government expenditure data due to weaknesses in its financial reporting systems (see Chapter 4).

¹¹ Treasury-executed expenditure includes donor assistance channeled through the National Treasury.

sectors will be limited if programmed improvements in revenue performance and growth rates fail to materialize. Second, even if programmed increases in aggregate expenditure are achieved, the additional resources mobilized will not be sufficient to finance the poverty reduction strategy laid out for priority sectors, particularly in agriculture and rural development where the expenditure base is currently very low, let alone the requirements of critical functions, such as the judiciary and road transport, that are given less prominence in the MTEF.

Table 2.2: Financing Reallocation, 1998 to 2001

Indicator	1998-99	1999-00	2000-01	1999 to 2003
No Institutions	33	33	33	33
No Institutions with Expenditure Cuts	7	6	3	5
No Institutions with Expenditure Increases	26	27	30	28
Cuts in Institutional Allocations \$m	(30.7)	(31.2)	(49.1)	(32.5)
Increases in Institutional Allocations \$m	85.6	78.7	87.9	173.8
Increase in Allocated Budget Base \$m	54.9	47.5	38.9	141.3
Priority Sectors Net Increment \$m	42.6	9.1	41.7	93.4
Defense and Security Net Increment \$m	1.2	(6.4)	(8.4)	(13.7)

Source: World Bank estimates based on MEF TOFE.

2.7 Government's priority development sectors—education, health, agriculture and rural development—have absorbed just over two-thirds of the increase in the base budget from 1998 to 2001. Allocations to the priority sectors have increased substantially—from 15.9 percent of Treasury-executed spending in 1998 (1.4 percent GDP) to 26.5 percent in 2001 (3.2 percent GDP) as recommended by the Bank's 1999 PER (see Table 2.3 and Table A3 in Annex A). In dollar terms, spending on the priority sectors has more than doubled from US\$ 45 million in 1998 to US\$ 115 million in 2001.

Table 2.3: Treasury-Executed Spending by Function, 1996-2003

(% of GDP)

Function	1996	1997	1998	1999	2000	2001	2002E	2003B
Core Government	6.7	6.4	6.5	5.8	7.0	6.5	5.3	5.1
General Administration	1.8	1.6	2.4	2.0	3.4	3.3	2.4	2.4
Defense	3.5	3.3	2.7	2.7	2.4	2.1	1.8	1.7
Security	1.4	1.5	1.3	1.1	1.1	1.1	1.0	0.9
Judiciary	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Economic Services	1.2	1.4	0.9	1.5	1.5	2.2	1.1	1.1
Agriculture	0.2	0.3	0.2	0.2	0.3	0.5	0.4	0.4
Transport	0.3	0.4	0.2	0.3	0.6	0.8	0.1	0.1
Public Works	0.3	0.3	0.1	0.2	0.6	0.7	0.1	0.1
Other transport	0.1	0.2	0.0	0.0	0.0	0.1	0.0	0.0
Other Economic Services	0.6	0.7	0.5	1.0	0.6	0.8	0.5	0.5
Environmental Protection	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Area Development	0.1	0.0	0.1	0.1	0.1	0.2	0.1	0.1
Social Services	2.1	2.2	1.8	2.8	2.9	3.6	4.2	4.1
Health	0.5	0.6	0.4	1.0	0.8	1.0	1.2	1.3
Recreation, Culture & Religion	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Education	1.0	0.9	0.9	1.2	1.3	1.7	2.1	2.0
Social Protection	0.5	0.6	0.4	0.5	0.7	0.7	0.7	0.6
Other	0.7	0.1	0.2	0.4	0.3	0.3	2.3	3.2
Debt	0.7	0.1	0.2	0.3	0.2	0.2	0.2	0.3
Other not classified	-	-	-	0.1	0.1	0.1	2.1	2.8
Total	10.8	10.2	9.3	10.6	11.8	12.8	13.0	13.6

Source: Bank estimates based on CDC Database and MEF TOFE.

2.8 Education and health have benefited from much of this increase. Education's share of Treasury-executed spending has risen from 9.4 percent in 1998 (0.9 percent of GDP) to 12.9 percent in 2001 (1.7 percent of GDP), and health's share from 4.2 percent (0.4 percent of GDP) to 7.9 percent (1 percent of GDP). In dollar terms, education spending has doubled from US\$ 27 million in 1998 to US\$ 56 million in 2001, with estimates indicating a further increase to US\$ 75 million in 2002. Health expenditure has nearly tripled from US\$ 11.8 million in 1998 to US\$ 34.2 million in 2001, with a further increase to US\$ 44.7 million in estimates for 2002. Nevertheless, levels of per capita spending are still modest, at US\$ 4.07 for health—far below the cost of a minimum package of services—and US\$ 6.81 for education in 2002. Significant increases in education and health sector allocations are programmed in the medium term expenditure framework, with their combined share programmed to reach 4.2 percent of GDP by 2005. Even so per capita spending will remain well below the average for low income countries.

2.9 Allocations to the other priority sectors have also increased sharply since 1998: rural development's share of Treasury-executed expenditure tripled from 0.6 percent to 1.8 percent, while agriculture's share has increased from 2 to 3.9 percent. However, the level of government spending on both these sectors remains extremely low in dollar terms, leaving the implementation of sector programs heavily dependent on donor financing. In 2001, Treasury-executed expenditures on agriculture amounted to just US\$ 17 million and rural development US\$ 7.8 million. Preliminary estimates presented in the NPRS provide for only marginal increases in these sectors' allocations for recurrent expenditures from 0.4 percent of GDP in 2001 to just 0.6 percent in 2005, suggesting limited scope for increased levels and quality of service provision.

2.10 The allocations for other critical functions, such as the judiciary and public works, are also of concern. The judiciary is currently allocated just 0.4 percent of Treasury-executed expenditures, about the same as environmental protection and less than 5 percent of the amount spent on security. Road maintenance is another area of concern. Recurrent spending on public works amounted to just 1.3 percent of total Treasury-executed expenditure in 2001 (0.2 percent of GDP), about US\$ 5.5 million. While the MTEF provides for modest increases in domestically-financed capital expenditures, much of which are allocated to road rehabilitation, from 1.4 percent of GDP in 2001 to 2 percent in 2005, increases in allocations for recurrent spending are less than 0.8 percent of GDP. This is clearly insufficient to meet the requirements of road maintenance programs (see Chapter 3).

2.11 Given that demands for increased spending in priority poverty reduction sectors exceed the resources that can be mobilized from incremental budget growth, there is a strong case for cutting base expenditures in the low priority sectors. In recent years additional resources have been mobilized by cutting defense and security expenditures from a peak of 47.3 percent of Treasury-executed expenditures (4.8 percent of GDP) in 1997 to 25 percent in 2001 (3.2 percent of GDP). This entailed a 36 percent reduction of defense spending in dollar terms and a 16 percent cut in security spending (see Table 2.4).

2.12 These cuts have been achieved by reducing the size of armed forces and cutting operational expenditures in both defense and security. Defense personnel costs were reduced by one quarter from 1996 to 2001, providing savings of US\$ 17 million, through first round demobilizations up to 1998 and a second round starting in 2000. Defense operating costs have been cut even more drastically, by more than half from 1996 to 2001, generating savings of US\$ 23 million. As a result, the personnel costs as a share of total defense spending have increased from 62 percent in 1996 to 72 percent in 2001. In contrast, security personnel costs increased by 45 percent over this period, as the security services have expanded, in part to accommodate some of the demobilized military. Consequently, the burden of cuts again fell on operating costs, which were cut by half over the six year period.

Table 2.4: Treasury-Executed Spending by Function, 1996-2003

(US\$, millions)

Function	1996	1997	1998	1999	2000	2001	2002E	2003B
Core Government	214.1	200.1	196.5	190.8	233.7	221.8	194.6	194.6
General Administration	58.2	49.7	73.7	66.2	115.2	111.6	89.0	91.2
Defense	111.2	103.4	83.4	88.1	80.1	71.7	67.2	65.5
Security	43.8	46.1	38.8	35.3	36.9	36.9	36.2	35.5
Judiciary	1.0	0.9	0.6	1.2	1.5	1.6	2.3	2.4
Economic Services	37.0	44.6	26.3	49.5	49.8	73.4	39.6	41.5
Agriculture	7.1	8.2	4.9	6.5	9.2	17.1	14.2	14.1
Transport	10.5	12.9	5.0	9.0	20.4	27.9	5.1	5.5
Public Works	8.9	8.2	3.5	7.7	18.8	23.4	3.7	3.7
Other transport	1.6	4.7	1.5	1.4	1.5	4.5	1.3	1.8
Other Economic Services	18.7	23.0	16.0	33.3	19.2	26.3	18.3	19.8
Environmental Protection	0.8	0.5	0.4	0.6	1.0	2.0	1.9	2.1
Rural Development	1.9	1.3	1.6	4.1	3.2	7.8	5.1	5.1
Social Services	66.5	67.2	53.3	92.1	98.6	122.4	151.1	157.0
Health	16.5	18.6	11.8	33.0	26.5	34.2	44.7	49.3
Recreation, Culture & Religion	2.0	2.4	1.8	2.6	7.2	8.4	6.5	7.5
Education	31.0	28.7	26.7	39.9	42.3	56.3	74.9	75.8
Social Protection	17.1	17.5	12.9	16.6	22.5	23.5	25.0	24.3
Other	22.3	3.2	5.3	12.3	11.4	9.7	84.3	122.0
Debt	22.3	3.2	5.3	8.6	8.0	7.7	6.3	12.9
Other not classified	-	-	-	3.7	3.4	2.0	78.0	109.0
Total	341.9	316.4	283.0	348.8	396.7	435.1	474.6	520.1

Source: MEF TOFE Reports and Bank estimates.

2.13 Further reductions in defense and security's share of spending are programmed to 2.6 percent of GDP in the 2003 budget and, in the NPRS to 2.4 percent of GDP in 2005. In dollar terms, defense and security expenditure is programmed to increase from US\$ 100 in 2003 to US\$ 112 million in 2005. An increase in the share of defense and security budget allocated to operational expenditures is already programmed in the 2003 budget. Consequently, while the scale and pace of demobilization will be critical in determining the volume of resources that can be mobilized from defense, close attention should also be paid to containment of increases in security services payroll and increases in operational expenditures in both sectors. Moreover, a review of the accuracy of defense personnel databases, which are regarded as inflated by both the Government and donors, would yield additional payroll savings.

2.14 Spending on general administration functions—including legislative and core executive functions, such as planning, finance, foreign affairs and information—has increased rapidly in recent years, from 18 percent of Treasury-executed spending in 1998 (1.9 percent of GDP) to 24.3 percent in 2001 (3.1 percent of GDP), a larger share than education and health combined. Forward estimates of recurrent expenditures presented in the NPRS, using a narrower definition excluding inter-governmental transfers and cross-governmental expenditures, indicate that general administration's share of expenditure will drop sharply from 2.4 percent of GDP in 2001 to 1.5 percent in 2003 and 1.35 percent in 2005. This entails holding expenditures roughly constant in dollar terms. Since there is pressure to increase spending on legislative and oversight functions, including the newly created National Audit Authority, the burden of efforts to contain expenditures is likely to fall on executive functions.

2.15 Reduction in administrative overhead offers an important source of savings. As in many countries with coalition governments, Cambodia has a large number of central government institutions with fragmented and sometimes overlapping responsibilities. There are, for example, ten ministries with portfolios in economic services and six with social service portfolios. Eight of

the twenty-four ministerial portfolios had budgets of less than US\$ 2 million in 2001, a large proportion of which are allocated to administrative functions rather than the provision of services. The large number of institutions is exacerbated by incremental budgeting, which leads to the dispersal of the resources mobilized from increases in the budget base. From 1998 to 2001, allocations for 28 of the 32 budget entities increased in dollar terms and a similar pattern is seen in the year-on-year increments. Institutional rationalization would release resources for service delivery in priority sectors. This would entail the redeployment, and possibly the retrenchment, of staff (see Chapter 5).

2.16 The MTEF demonstrates the Government's commitment to increased expenditure on priority poverty reduction services, yet the scope for resource reallocation is limited using an incremental approach. While spending on education and health is programmed to increase significantly, increases in allocations for agriculture and rural development from their present low base are modest. Moreover, there is little scope for increasing allocations to other critical functions, such as the judiciary and road transport. Integration of these sectors into the next round of the MTEF would enable Government to program further increases in resources to support the strategy laid out in the NPRS. At the same time there is a need to identify opportunities for resource reallocation from the base budget. Further demobilization and capping of increases in defense and security services operational expenditures offer one source. Rationalization of administrative structures offers another.

TRENDS IN THE ECONOMIC COMPOSITION OF EXPENDITURE

2.17 Changes in the functional composition of expenditures have been accompanied by a restructuring of their economic composition. Whereas the share of salaries and allowances in defense and security has increased significantly since 1996, the share of salaries and allowances in civil administration expenditures has fallen. Conversely, the share of spending on operations, special program activities and capital expenditures has increased. This would be considered a positive trend were it not that the current levels of pay are insufficient to support a motivated civil service.

2.18 Spending on civil administration salaries and allowances has increased from 1.3 percent of GDP in 1998 to 1.7 percent in 2001, yet growth trailed increases in total expenditures. Increases in civil administration expenditures on salaries and allowances have trailed growth in the budget base so that the share of total expenditures has fallen from a peak of 27 percent in 1997 to just 18 percent in 2001. Budget data suggest that the increase in the nominal expenditures on salaries and allowances was driven by an increase in staffing levels from 1996 to 2000. Education has absorbed much of this increase, its share of civil administration expenditures on wages increasing from 48 percent in 1996 to 57 percent in 2001.

2.19 Recognizing that low levels of pay are a major constraint to improved public sector performance, the Government recently implemented the first round of its pay reform strategy (average monthly remuneration increased by 44.3 percent to US\$ 28 in May 2002). The RGC has previously constrained the total wage bill, including defense and security, to be less than 40 percent of recurrent spending (see Table 2.5). However, while the 40 percent limit does serve the purpose of highlighting the tradeoffs between levels of staffing and remuneration, it is artificial. A more strategic approach would address the tradeoffs between base and incremental expenditures on public sector pay and those on operations and capital.

2.20 Civil administration operational expenditures increased by 140 percent from 1998 to 2001, as recommended by the 1999 PER from US\$ 58 million to US\$ 139 million. The priority sectors have benefited from over half this increase, health and education alone from over 40 percent. By 2001, health and education accounted for 34 percent of total civil administration

operational expenditures, up from 23 percent in 1998. Over the same period, general administration's share dropped from 55 percent to 43 percent. As a result of this shift in resources to operational expenditures, the ratio of operational expenditures to spending on salaries and allowances has increased significantly across civil administration, from CR 1.42 for each Riel spent on salaries and allowances in 1998 to CR 2.36 in 2001, with the greatest increase seen in the priority sectors (see Annex A, Table A5). The combination of the 40 percent indicative ceiling on the wage bill (as a percentage of recurrent expenditures), combined with the programmed spending shift toward the priority sectors, produced a pincer-like effect on the economic composition of spending, in effect, reducing the share of spending on salaries and allowances significantly from 1998-2002.

Table 2.5: Treasury-Executed Civil Administration Expenditure by Economic Category, 1996-2003

	(%)							
Budget Chapter	1996	1997	1998	1999	2000	2001	2002E	2003B
Sub-Total Current Expenditure	78.1	80.7	79.8	73.0	70.9	77.4	80.4	78.7
10: Salaries and allowances	24.8	27.2	25.4	22.2	19.8	18.1	21.4	19.6
11: Operating costs	32.0	33.5	31.4	31.3	33.2	36.9	31.5	27.1
12: Subsidies for provincial admin.	3.4	3.4	2.7	1.7	1.8	1.9	3.5	6.2
13: Special program agreements	0.1	0.2	4.8	0.6	1.0	5.8	9.5	9.2
20: Interest on loans	2.6	1.9	2.4	2.6	2.0	1.7	1.7	1.6
30: Economic transfer payments	3.1	1.3	2.4	1.4	2.9	2.7	2.9	2.0
31: Social transfer payments	10.9	12.5	10.4	10.9	8.4	9.0	7.9	6.3
32: Transfer to international org.	1.2	0.2	0.4	0.6	0.6	0.7	0.6	0.3
40: Miscellaneous	-	0.4	-	1.6	1.2	0.6	1.4	5.6
41: Contingencies								0.6
Sub-total Capital Expenditure	21.9	19.3	20.2	27.0	29.1	22.6	19.6	21.3
50.1: Construction & Equipment	10.6	14.8	13.9	22.5	20.6	15.0	15.0	8.4
50.2: Counterpart funds	2.0	3.3	5.4	3.2	7.5	4.2	4.1	4.1
50.3: Investment by foreign funds						2.8	0.5	7.3
52: Financial Operations	-	0.0						
53: Debt amortization	9.3	1.2	0.9	1.2	0.9	0.7		1.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: MEF TOFE reports.

2.21 Analysis of the structure of operating and maintenance expenditures (Chapter 11) in the four priority sectors confirms that administrative overhead tends to predominate when sector allocations for operational expenditures are modest. Operational expenditures channeled through the conventional budget execution mechanism, cover both administrative costs, including office costs, vehicle costs, expenditure on meetings and training, and travel, as well as a range of program expenditures. In the case of rural development, for instance, administrative overhead accounted for 99 percent of Chapter 11 expenditures in 2001. In agriculture, administrative overheads amounted to about 60 percent of Chapter 11 expenditures. In education the share of administrative expenditures has dropped steadily as Chapter 11 (and Chapter 13) allocations increased in recent years, from 32 percent of total operating expenditures in 1999 to 26 percent in 2001. However, some operating expenditures might not be efficiently allocated. For example, of total MOEYS Chapter 11 spending in 2001, 69.7 percent was spent on sports ("matches and utilities"), and fully 79 percent of the total increase in Chapter 11 (1999-2001) had been allocated to sports. It may be that in some sectors, as Chapter 13 is "priority" expenditure, Chapter 11 has become "non-priority" spending. In the health sector, on the other hand, administrative overheads have dropped from 35 percent of operating expenditures to 22 percent over the same period. Medicines accounted for 62 percent of health Chapter 11 operating expenditures in 2001, up from 48 percent in 1999, and medical equipment a further 15 percent.

2.22 The RGC has sought to increase allocations for capital expenditure by running a current budget surplus.¹² Project-related expenditures have increased from just 6.9 percent of Treasury-executed expenditures (0.7 percent of GDP) in 1996 to 19.8 percent (2.3 percent of GDP) in 2000, before dropping back to 16.6 percent (2.1 percent of GDP) in 2001. While there has been some increase in counterpart funds, the bulk of these resources has been allocated to Government projects. In 2001, spending on Government projects amounted to US\$ 50 million.

2.23 The structure of spending on government projects is erratic at the sector level, reflecting the impact of a few major construction projects on a relative small government project portfolio. (See Table 2.6) In 2001, the economic sectors accounted for 61 percent of total government project expenditures, with public works accounting for about one-third, amounting to about US\$ 15 million. Allocations for other priority sectors tend to be much lower (rural development 8.6 percent in 2001, agriculture 7 percent, education 5.3 percent and health 0.2 percent). Despite the modest levels of Treasury-executed expenditure on Government projects in public works, projects still account for about two-thirds of sector spending (63 percent in 2001). This is equally true of the rural development sector, where project expenditures of US\$ 4.2 million accounted for about half of sector spending in 2001 (See Table 2.7).

Table 2.6: Expenditure on Government Projects by Function, 1996-2001

	(%)					
Function	1996	1997	1998	1999	2000	2001
Core Government	48.2	24.2	55.8	14.3	48.3	15.8
General Administration	48.1	2.5	50.5	13.0	48.2	14.9
Defense	-	-	-	-	-	0.9
Security	-	21.7	4.8	1.2	-	-
Judiciary	0.2	-	0.4	0.1	0.0	-
Economic Services	43.5	62.5	38.5	50.1	38.9	61.1
Agriculture	4.5	9.3	3.4	0.3	2.3	7.0
Transport	32.8	25.7	10.9	11.1	24.4	35.9
Public Works	29.3	13.7	7.6	10.2	23.5	30.0
Other transport	3.6	12.0	3.3	1.0	0.9	5.8
Other Economic Services	5.9	27.4	24.2	38.6	12.2	17.9
Environmental Protection	0.3	0.1	-	0.0	-	0.3
Rural Development	5.4	1.4	4.3	6.4	2.2	8.6
Social Services	2.9	11.9	1.4	29.3	10.7	14.5
Health	0.7	8.4	0.5	25.6	0.2	0.2
Recreation, Culture & Religion	0.1	0.3	0.2	0.0	5.4	7.6
Education	1.9	1.2	0.4	3.0	1.8	5.5
Social Protection	0.2	2.0	0.3	0.6	3.3	1.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: MEF TOFE Reports.

2.24 Maintenance expenditures are inadequate in relation to the current levels of capital spending and the capital stock, giving rise to concerns regarding the sustainability of the investment program. In health, for instance, reported maintenance expenditures in 2001 amounted to just 5.7 percent of cumulative Government project expenditures in the sector over the 1996 to 2001 period. This proportion drops even further when one considers that Government

¹² Treasury-executed capital expenditure comprises debt amortization, counterpart contributions to externally financed projects, Government-financed construction and equipment projects and, from 2001, external financing for projects channeled through the Treasury. Counterpart contributions are allocated as required by the MEF and are, for the most part, posted against MEF rather than the implementing agency. Similarly, allocations for Government projects are held as a reserve for allocation by the MEF on the advice of the Office of the Prime Minister (OPM) during the course of the year. Given these information constraints, trends in the structure of capital spending must be interpreted with caution.

projects account for less than one-tenth of total investment in the health sector, most of which is financed by external partners, and less than half of maintenance spending is on infrastructure, most being used for equipment and vehicles. Levels of maintenance spending are even lower in other priority sectors: in education, total maintenance expenditures in 2001 amount to just 2.9 percent of cumulative expenditures on government projects for the period 1996 to 2001; in rural development, just 2.5 percent; and in agriculture less than 0.1 percent. In the absence of sufficient funding for routine maintenance, a large part of the capital spending is directed at rehabilitation of the infrastructure rather than increases in the capital stock.

Table 2.7: Government Projects as Share of Total Sector Expenditure, 1996-2001

	(%)					
Function	1996	1997	1998	1999	2000	2001
Core Government	4.3	3.8	6.6	3.8	11.9	3.5
General Administration	15.8	1.6	16.1	10.1	24.2	6.6
Defense	-	-	-	-	-	0.6
Security	-	14.8	2.9	1.8	-	-
Judiciary	3.2	-	17.4	3.5	1.2	-
Economic Services	22.4	44.2	34.3	52.1	45.1	41.2
Agriculture	12.3	35.9	16.4	2.2	14.2	20.3
Transport	59.5	62.8	51.4	63.3	69.2	63.5
Public Works	62.6	52.7	51.2	68.1	72.0	63.3
Other transport	42.7	80.1	51.8	36.0	35.2	64.3
Other Economic Services	6.0	37.7	35.3	59.7	36.6	33.6
Environmental Protection	6.4	4.0	-	2.7	-	7.4
Rural Development	54.5	35.8	63.1	79.3	38.9	54.5
Social Services	0.8	5.6	0.6	16.4	6.3	5.9
Health	0.8	14.2	1.0	40.0	0.4	0.2
Recreation, Culture & Religion	0.5	4.2	3.0	0.2	43.4	44.8
Education	1.2	1.3	0.3	3.9	2.5	4.8
Social Protection	0.2	3.6	0.5	2.0	8.4	2.8
Total	6.0	10.1	8.4	15.3	15.0	11.6

Source: MEF TOFE Reports.

EXTERNALLY-FINANCED EXPENDITURE

2.25 Reported external assistance flows are significantly higher than the volume of Treasury-executed expenditures (US\$ 2,122 million) over the period 1996-2001. From 1996 to 2001, reported flows of external assistance totaled US\$ 2,672 million, of which roughly US\$ 190 million has been provided as budgetary and balance of payments support, US\$ 220 million as humanitarian assistance, and the remaining US\$ 2,264 million through projects and program activities. Although the gap between external and domestic financing is narrowing, the level of reported external assistance flows in 2001, at US\$ 472 million, still exceeded domestic revenues, at US\$ 390 million, by a significant margin.

2.26 The bulk of this assistance has been channeled off-budget, both in the sense that resource allocations are not reflected in the Government's budget documents and that funds are not disbursed through Treasury. Consequently, it is not possible to present a consolidated picture of total expenditures from budget documents and budget execution reports. For the purposes of this analysis, data on external financing is based on data collected directly from donors by the Council for the Development of Cambodia (CDC). However, coverage is incomplete and data consolidation is hampered by information gaps and a non-standard functional classification.

2.27 There has been a gradual shift in the functional composition of external assistance, though there is no marked trend toward the priority sectors (see Table 2.8, 2.9, and Table A6 in Annex A). The data set developed for the IFAPER allows rough estimates of external financing by function since 1996 and a more comprehensive analysis of externally financed expenditure in 2001.¹³ The share of external financing allocated to core government functions dropped sharply after the 1998 elections. There has also been a gradual reduction in financing for economic development, particularly in communications and more recently energy, though allocations for transport, mostly for road rehabilitation, have increased sharply from US\$ 34 million in 1999 to US\$ 60 million in 2001. External financing for social development has gradually increased, accounting for over 40 percent of total external financing in 2001. However, there is no marked trend indicating a reallocation of external financing toward the Government's long-term priority sectors. Indeed, financing for health and education has declined from a peak of US\$ 120 million in 1998 to US\$ 111 million in 2001. Most of the increase in external financing of social development has been absorbed by community and social services, including social protection and community amenities such as water supply, which has doubled over the same period to US\$ 69 million in 2001.

Table 2.8: Functional Structure of External Assistance, 1996 to 2000

(% of Total Spending)						
Summary Function	1996	1997	1998	1999	2000	2001
Core Government	29.2	30.2	31.1	15.2	12.5	14.7
Economic Development	81.9	69.7	80.7	66.4	69.9	58.8
Agriculture	90.1	68.8	71.7	79.7	82.7	67.4
Transport	85.1	74.2	90.5	79.0	69.8	68.1
Other Economic Services	67.6	64.4	74.7	51.5	53.6	24.4
Environmental Protection	80.5	91.7	90.0	82.8	68.1	33.4
Area/Rural Development	97.7	98.2	97.5	93.4	95.4	88.8
Social Development	59.9	59.6	74.3	59.6	59.5	59.6
Health	72.6	63.3	84.2	68.3	71.9	65.9
Education	52.9	62.7	68.6	50.3	48.9	44.4
Community & Social services	52.2	48.6	69.1	56.3	55.1	68.6
Humanitarian Aid & Relief	100.0	100.0	100.0	100.0	100.0	100.0
Total	56.5	54.1	60.1	51.7	51.9	49.4

Source: Bank staff estimates based on CDC database) and MEF TOEF reports.

2.28 While the share of external financing in estimated total expenditures has gradually fallen, key sectors remain heavily dependent on external financing. External financing still accounts for around two-thirds of the sector spending in health, agriculture, rural development, and transport. In the case of rural development, the external assistance portfolio completely dominates the sector.

2.29 Cambodia's external assistance portfolio is heavily geared toward technical assistance. Spending on technical assistance, comprising both personnel charges and training and associated operational expenditures is estimated at US\$ 162 million in 2001, around 45 percent of the external assistance project portfolio, excluding humanitarian assistance, and 21 percent of combined domestic and externally-financed expenditures (see Table 2.10). On this basis spending on technical assistance exceeds the Government's total wage bill and is nearly three times Government spending on civil administration wages. Technical assistance inputs constitute a

¹³ CDC data has been consolidated into a summary functional classification, and adjustments have been made to avoid double counting budgetary and balance-of-payments support (included in government expenditures) and, for 2001, bilateral financing of projects executed through multilateral agencies. Due to these adjustments, totals differ from those given in recent CDC reports.

particularly large share of total expenditure in the priority sectors, ranging from nearly half of total spending in area development and agriculture, to just over one fifth of total expenditure in education. While technical assistance inputs provide an important contribution in terms of capacity building and institutional reform, over time there is a need to shift more resources toward investment, and, under the right conditions, toward financing operational costs through budgetary support in health and education. In the medium term, however, there is a case to be made for creative thinking about the possibility of rechanneling some technical assistance funds, including salary supplements, toward wage expenditures (see Chapter 5).

Table 2.9: Total External Assistance by Summary Function, 1996-2001

(US\$, millions)

Summary Function	1996	1997	1998	1999	2000	2001
Core Government	88.2	86.7	88.7	34.2	33.5	38.3
Economic Development	167.1	102.7	110.3	97.6	115.5	104.6
Agriculture	64.6	18.0	12.4	25.6	44.1	35.4
Transport	60.2	37.2	47.1	33.9	47.1	59.7
Other Economic Services	38.9	41.6	47.3	35.3	22.1	8.5
Environmental Protection	3/3	5.8	3.5	2.8	2.1	1.0
Area Development	78.1	67.9	63.3	58.1	67.3	61.9
Social Development	99.3	99.1	154.3	136.1	144.6	180.7
Health	43.7	32.0	63.0	70.9	67.7	66.1
Education	34.7	48.3	58.3	40.4	40.5	45.0
Community & Social services	20.8	18.8	33.1	24.7	36.4	69.6
Humanitarian Aid & Relief	12.3	15.8	9.8	47.2	66.9	40.1
Total	444.9	372.2	426.4	373.3	427.9	425.5

Source: Bank estimates based on CDC database and MEF TOFE reports.

Table 2.10: Expenditure by Source of Financing and Input, 2001 ^{a/}

%

Summary Function	Domestic Financing				External Project Financing			
	Total	Salaries	Other Recurrent	Capital	Total	FTC & ITC	IPA	Total
Core Government	86.3	34.5	43.7	8.1	13.7	11.6	2.0	100.0
Economic Services	40.0	3.2	16.6	20.3	60.0	19.1	40.8	100.0
Agriculture	32.4	3.5	15.8	13.0	67.6	47.6	20.0	100.0
Transport	31.1	2.0	5.7	23.4	68.9	2.7	66.2	100.0
Other Econ. Serv.	72.7	5.3	42.3	25.0	27.3	14.4	12.9	100.0
Env. Protection	45.7	7.4	34.7	3.6	54.3	50.6	3.7	100.0
Area/Rural Dev.	12.9	0.6	4.7	7.6	87.1	54.8	32.2	100.0
Social Services	43.7	13.8	26.4	3.4	56.3	23.0	33.3	100.0
Health	38.5	4.0	33.4	1.1	61.5	30.0	31.5	100.0
Education	58.6	34.9	19.4	4.3	41.4	22.9	18.5	100.0
Community Serv.	-	-	-	-	100.0	2.2	97.8	100.0
Other Social Serv.	65.2	3.5	52.7	9.1	34.8	30.5	4.3	100.0
Total	54.5	17.1	28.1	9.2	45.5	20.8	24.7	100.0

^{a/} Constructed based on classification of individual projects.

Source: Bank staff estimates based on CDC database and MEF TOEF reports.

2.30 Externally financed project expenditures at the provincial level account for about 16 percent of total expenditures, while domestic financing at the provincial level accounts for about 12 percent of the total (Table 2.11). Decentralized external project financing is thus a particularly important in the rural/area development and transport sectors. Externally financed national projects and programs, with activities at both central and provincial levels, comprise a

substantial share of total expenditures in the priority sectors, accounting for 47 percent of the total in health, 27 percent in agriculture, and 22 percent in education. This tends to point to greater deconcentration of external as compared to Treasury-executed expenditures (see Chapter 6).

Table 2.11: Expenditure by Source of Financing and Administrative Level, 2001 ^{a/}

(US\$, millions)								
Summary Function	Domestic Financing				External Financing			
	Sub-Total	Central	Pro-vincial	Sub-total	Central Adm. & Policy	National & Pro-vincial	Phnom Penh	Provinces
Core Government	221.8	213.2	8.7	35.1	26.8	7.2	0.3	0.8
Economic Services	73.4	66.2	7.2	109.9	12.6	23.3	5.2	68.8
Agriculture	17.1	13.7	3.4	35.8	5.7	14.5	-	15.6
Transport	27.9	26.4	1.6	61.8	2.8	6.0	1.7	51.2
Other Econ. Serv.	26.3	24.5	1.8	9.9	3.1	2.0	3.5	1.3
Env. Protection	2.0	1.6	0.4	2.3	0.8	0.7	-	0.8
Area/Development	7.8	6.3	1.5	52.4	1.8	11.3	-	39.4
Social Development	122.4	49.0	73.4	157.9	37.3	74.9	30.5	15.1
Health	34.2	23.5	10.6	54.6	9.3	41.5	2.2	1.6
Education	56.3	15.1	41.2	39.7	12.2	21.3	-	6.3
Community Services	-	-	-	46.6	0.5	18.3	26.9	0.8
Other Social Services	31.9	10.4	21.5	17.0	6.2	2.9	1.5	6.5
Total	425.3	334.6	90.7	355.3	78.5	116.6	36.1	124.1

^{a/} Constructed based on classification of individual projects.

Source: Bank staff estimates based on CDC database and MEF TOEF reports.

CONCLUSION

2.31 Since 1998 the Government has made significant progress in reallocating resources to its priority sectors, and the NPRS demonstrates the Government's continued commitment. The Government's priority development sectors—education, health, agriculture and rural development—have absorbed just over two-thirds of the increase in the Treasury-executed spending from 1998 to 2001. The MTEF demonstrates the Government's commitment to continue increasing expenditure on priority poverty reduction sectors, yet the scope for reallocation is limited using an incremental approach.

2.32 Generating additional resources from savings elsewhere is thus a top priority, given existing commitments to increase allocations further to health and education, and the need to provide additional funding to the economic services sector over the medium to long term—including road transport and, under the right conditions, agriculture and rural development. There is thus a clear need to identify opportunities for resource reallocation away from low priority sectors and programs. Rationalization of administrative structures, including retrenchment, offers another avenue. Reductions in indirect costs, primarily administrative overhead, would also afford the Government additional resources. In sum, it is clear that expenditure reallocation—from low priority sectors, programs, and activities—will need to form part of the Government's medium term expenditure plan in order to meet the objectives of the NPRS.

3. POLICIES, EXPENDITURES, AND OUTCOMES IN PRIORITY SECTORS: HEALTH, EDUCATION, AGRICULTURE AND ROAD TRANSPORT

“It is now widely recognized that poverty is a multidimensional problem and should be viewed in a broader context than merely in terms of low levels of consumption and income. Lack of food, uncertainties about access to natural resources, powerlessness and hopelessness, social exclusion, lack of education, etc. are all dimensions of poverty.”¹⁴

INTRODUCTION

3.1 Cambodia’s NPRS provides the road map for moving forward with poverty reduction policies over the medium term. This section examines the links between policy, expenditures, and outputs/outcomes in four priority sectors: health, education, agriculture/rural development, and road transport.¹⁵ The objective of this chapter is to assess the impact of public expenditure policy and management on different dimensions of poverty.

3.2 As the NPRS states, “poverty is a multidimensional problem.” From agricultural production and road transport to education and health, affecting men and women differently along the way, and taking on different manifestations in rural as opposed to urban areas, poverty is multi-faceted. The NPRS, building on the SEDP II, represents the Government’s bold attempt to reduce poverty in its many dimensions simultaneously, recognizing the inter-related nature of poverty characteristics, for men and women, and for rural and urban families. The effectiveness of resource use depends critically on line agencies, and individual sectors’ decisions about *policy priorities* and *sectoral expenditure allocations*, which translate into *expected outputs and outcomes*, all of which determine whether poverty decreases or not, and, if so, how.

3.3 The effectiveness of public expenditure policy and management in delivering services efficiently will depend, fundamentally, on three overarching factors: (a) the nature of poverty, (b) the characteristics of the service delivery production processes in each sector, and (c) the strength of accountability mechanisms. This section briefly addresses each of these overarching issues to set the context for analysis of the impact of sector programs on poverty reduction.

The nature of poverty¹⁶

3.4 Poverty in Cambodia is widespread, with over one-third of the population living below the poverty line, with significant regional variation. Poverty is much more concentrated in rural areas as compared to urban areas, especially Phnom Penh. The data suggest that the reduction in poverty occurred principally in urban areas, indicating the necessity of delivering services to rural areas if services are going to have an impact on poverty. The data also suggest that progress in reducing poverty, as measured by the headcount index, was slow in the late 1990s, raising questions about the efficiency and effectiveness of public service delivery, though

¹⁴ “Cambodia: National Poverty Reduction Strategy,” December 2002, p. 15.

¹⁵ Both outcome and output indicators are utilized to the extent that they are available.

¹⁶ The poverty analysis is based on the NPRS (2002), Chapters 3 and 4.

trends in social indicators are more positive (see the sections on health and education below).¹⁷ Poverty is manifested comparatively in Cambodia's low rank in the Human Development Index—130—just below Myanmar and India, its low rank in the Gender Development Index—the lowest in Asia—and a life expectancy of only 56.4 years.

Table 3.1: Headcount Indices, Overall Poverty Line, 1997 and 1999

Regions	1997 (Adjusted)	1999 (Round 2)
Phnom Penh	11.1	9.7
Other Urban Areas	29.9	25.2
Rural Areas	40.1	40.1
Cambodia	36.1	35.9

Source: A Poverty Profile of Cambodia (1997 and 1999), MOP.

3.5 Poverty in Cambodia is closely associated with agriculture. The overwhelming majority of the poor, 79 percent, are those with heads of households employed in the agricultural sector. Land distribution in Cambodia is inequitable, and the large majority of the poor own small parcels of land. In the period 1998-2000 the average growth rate of agricultural employment was only 1.6 percent.

3.6 Lack of opportunities, in the form of access to public services such as health care, education, agricultural extension, and transportation, impedes movement out of poverty. Moreover, the constraints that impede movement out of poverty are intrinsically cross-sectoral. Poor health is the major cause of impoverishment and other forms of social deprivation (e.g., loss of educational and employment opportunities). The cycle of poverty, ill health, and high health care costs can economically cripple a typical Cambodian family. An Oxfam study of landlessness found that 40 percent of new landlessness was related to ill health. Poor nutrition reduces children's ability to absorb education, reducing the effectiveness of educational spending. In turn, poverty rates are higher for households in which the head has had either no formal education or only some primary schooling. Children also lose schooling opportunities because they must support their families with their labor. And access to markets is impeded by inadequate infrastructure, especially roads, which results in high transport costs.

3.7 The poverty context in which public services are produced and delivered, briefly assessed here, indicates the rural yet multidimensional nature of poverty in Cambodia. Given its multidimensionality, service delivery interventions, to be effective, would need to address a wide range of issues simultaneously across the priority sectors—education, health, agriculture, and transport—both in terms of increasing equity and growth. Inter- and intra-sectoral policy formulation is thus the starting point for the production of poverty-reducing services, but it is only the starting point. Implementing those policies efficiently and effectively is necessary, yet in many ways much more challenging.

The Service Delivery Production Process and Accountability: A Simple Framework

3.8 This chapter proposes a simplified framework for analysis of the service delivery production chain. Ideally, policies, based on agreement about priorities, determine expenditures, which are translated into outputs that in turn generate improved outcomes consistent with policy intentions. A simple production chain highlights the key linkages that, if not functioning properly, could lead to a breakdown in service delivery. Broadly speaking, there are four links. The first is the *development of appropriate sector policy* based on government priorities, informed by data, past performance, users' concerns, etc. A lack of clarity or focus in sector policy making can seriously hamper the production of priority services. *Linking policy to expenditures* is the next

¹⁷ Problems with the validity and reliability of the 1999 data set are discussed in the NPRS, p. 33.

step. This requires a strategy, or operational plan, complete with costings of programmatic areas linked to the annual budget and medium term resource planning. This also requires a budget system that facilitates linking programs with expenditures. The *link between expenditure allocations and outputs depends on efficiency and effectiveness* in organizational production processes. If expenditures are inefficiently allocated, services will be inefficiently and inadequately produced. The lack of a results-oriented management perspective in all but two sectors has made it difficult to link expenditures and outputs, and to monitor progress in doing so (see Box 3.1). Lastly, *the link between outputs and social welfare outcomes* will determine the extent to which poverty is actually reduced. This last link is the most difficult to analyze, in part because of the causal complexity of a process such as poverty reduction, and given available data, this link is necessarily probed in a preliminary way.

Box 3.1: Results-Oriented Public Expenditure Management in Cambodia

A recent study found that Cambodia has made some progress in developing a result-oriented perspective in pursuit of its poverty-reduction agenda, but has far to go. The study concludes that:

- In broad terms Cambodia has already adopted a number of performance targets relative to its poverty reduction goals.
- The extent to which ministries have translated performance targets into medium term sectoral performance objectives varies—from considerably to not at all—by sector.
- While it is generally the case that most ministries have neither costed nor operationalized targets, thus resulting in inappropriate resource allocations, there are other reasons that better explain slow progress in this regard.
- Some sectors in Cambodia pursue policies inconsistent with or inimical to stated poverty reduction objectives.
- Management gives little or no guidance to front line providers on the results expected from them.
- It is broadly true that Cambodia gives rather superficial political and parliamentary scrutiny to the causes of performance below expectation and is reluctant to hold those responsible to account.

Cambodia has considerable progress to make in monitoring implementation and outputs of poverty-reducing expenditure programs.

Source: Dom, Ensor, and Suy (ODI, 2003).

3.9 Each of these links in the service delivery production process is underpinned by accountability relationships between service providers and beneficiaries. One of the reasons for shortcomings in service delivery performance—manifested through ineffective links between policies and outcomes and inefficiencies in expenditure—is often the lack of effective accountability mechanisms. Practitioners and academics are increasingly of the belief that to improve service delivery outcomes, citizens, civil servants, and politicians need to work better together. The central idea is that outcomes will improve when service delivery beneficiaries are able to hold politicians and civil servants accountable for results.

3.10 Accountability depends on the strength of the institutions—both formal and informal—that mediate the relationships between: citizens and politicians, politicians and civil servants, and citizens and civil servants.¹⁸ Citizens hold politicians accountable through formal political institutions, including political parties and elections, as well as through informal mechanisms, including NGOs and advocacy campaigns. The relationship between politicians and civil servants depends on both political and institutional arrangements. These include the incentives faced by civil servants and the resources available to them: Are civil servants rewarded for good technical performance or for political reasons (e.g., patronage)? Does public sector remuneration promote professionalism? Is sufficient information available to judge bureaucratic performance? The relationship between citizens and civil servants also plays a role in determining

¹⁸ Adapted from the *World Development Report 2004*, forthcoming.

service delivery outcomes. It is critical for citizens to have mechanisms to express their preferences to frontline service providers and to have the ability to monitor them on a continuous basis.

3.11 Weaknesses in these formal and informal accountability mechanisms in Cambodia have a negative impact on the efficiency and effectiveness of public sector spending, and thus on poverty reduction. To the extent that citizens do not have effective means to express their preferences both to politicians and frontline service providers the efficiency of spending may be reduced. To the extent that citizens do not have effective means to monitor the outputs and outcomes produced by the public sector, the effectiveness of spending may be reduced. One recent positive development in this regard is the relatively inclusive and transparent process that characterized the NPRS. Scaling up participatory mechanisms that promote inclusion and transparency would likely have significant positive effects on service delivery outcomes, thereby increasing the value for money of each riel spent (see Box 4. on participatory approaches in public expenditure management).

3.12 The approach is to examine the simple model of service delivery in depth in each of the following sectors: education, health, agriculture/rural development, and road transport (with the exception of the last, all are considered by the RGC as priority sectors). Overall, the chapter finds that the RGC has made progress in improving the efficiency and effectiveness of priority sector spending, especially in health and education. This is even more significant when considered in the context of the findings of Chapter 2—that the RGC has also made impressive progress in increasing funding for the priority social sectors. The analysis also finds, however, two important weaknesses. The first is that *sub-sectoral expenditure allocation could be greatly improved in all the sectors examined*. The second is that *the agriculture and road transport sectors are lagging behind*, raising serious concerns about the efficiency and effectiveness of expenditures in these sectors. This problem is complicated by the fact that overall levels of spending on economic services are inadequate for growth and poverty reduction objectives.

3.13 The analysis finds that the development of appropriate policy and the linking of policy to expenditures has been quite uneven across sectors. In education and health planning processes have improved and greater linkages between planning and budgeting have been developed, resulting in improved prioritization of spending. Agriculture and road transport have yet to make progress on this front. Lack of development in lagging sectors is becoming a binding constraint on better resource use and poverty reduction.

3.14 Moreover, at the sub-sectoral composition of spending level, there is much room to improve overall allocative efficiency: the linkage between expenditures and the production of services is weakened by misallocation of resources. Some key trends are apparent:

- (a) *economic composition*—the wage share of spending has decreased across the board and is unsustainably low; spending on maintenance is too low in some sectors (health and road transport); inefficiencies are noted generally in high levels of spending on indirect costs (viz., administrative overhead);
- (b) *geographic allocation*—spending on provincial level facilities is too low in all sectors, relative to central ministry expenditures, given that the provinces are where the majority of the poor reside, which also suggests inefficient spending at the central level in the form of high indirect administrative costs; and
- (c) *programmatic allocation*—expenditures are targeted to the poor in education, but less so in health, and only marginally in agriculture. There has also been progress in improving the coverage of services in both education and health, though not in agriculture.

3.15 Gender analysis in each of the priority sectors also shows that there are systemic barriers to access for women and girls across Cambodia. This suggests an important role for the incorporation of gender analysis at the policy development stage (see Chapter 4 as well). The chapter thus shows that breakdowns in service delivery production occur at all three levels: policy development, linking policies and expenditures, and linking expenditures and outputs/outcomes. Given the weaknesses in policy development and linkages between policies and expenditures, with the exception of education, there is much room for improvement. Indeed, transforming resources into poverty-reducing services will require substantial reform at the sectoral level, from policy making, to expenditure planning, to service delivery management.

3.16 The analysis also argues for moving beyond a rigid understanding of “priorities” to a more nuanced approach. The concept of the “priority sector” served the RGC well as it undertook a major shift in resource allocation over the past few years. In some sectors, such as health and education, high priority programs have been identified, which naturally implies the existence of lower priority programs. The analysis shows, however, that low priority programs, even in the high priority sectors, continue to receive disproportionate funding. In other sectors, such as agriculture and rural development, the priority concept has not trickled down to the sector program level. At the same time the gender analysis shows that some gender-related programs, which ought to be high priority, are not. And some sectors, such as road transportation and the judiciary, might deserve higher priority status. Thus the analysis suggests a review of the status and definition of priority sectors and a more nuanced approach that identifies priority programs at the sectoral and cross-sectoral level in order to improve the targeting of resources to pro-poor programs.

HEALTH

- *Policy and Planning:* The health sector has made important progress by basing its strategy on monitoring outputs and outcomes, though further work is necessary to cost and operationalize the strategy by linking it effectively to the budget.
- *Expenditures:* Overall government spending has increased significantly over the past few years, though the allocative efficiency of spending could be increased. In economic terms: the wage share is too low as a proportion of recurrent spending; and maintenance spending is inadequate, though non-wage recurrent spending has been increasing. The share of spending at the provincial level is too low and the high inter-provincial variance results in inequalities in per capita spending across the country. The result is inadequate targeting of resources, which reduces the pro-poor impact of spending.
- *Outputs and Outcomes:* There have been some significant achievements in the sector, including a decline in the level of some communicable diseases, and expansion of physical coverage of the system, and piloting of innovative management systems. However, serious problems need to be addressed: low and uneven access to services, and the fact that the incidence of spending is skewed away from the poor and toward middle income and wealthy groups.

Sector policy and planning

3.17 The health sector strategic plan (HSSP) identifies the goals and objectives of the MOH and the wider health sector, putting forward eight key strategies for their achievement. The HSSP, completed in August 2002, was written by a core group of MOH officials, but is based on wide consultations within the government, as well as the NGO and donor communities (see Table 3.2). Closely linked to the HSSP is the health section of the NPRS,

which contains the main elements of the HSSP that affect the poor (e.g., the NPRS places considerable emphasis on the financial and physical barriers to accessing services by the poor).

Table 3.2: The Health Sector Strategic Plan, 2003-2007

Goal	Outcomes
Enhance health sector development in order to improve the health of the people of Cambodia, especially mothers and children, thereby contributing to poverty alleviation and socio-economic development.	➤ Reduced infant mortality rate ➤ Reduced child mortality rate ➤ Reduced maternal mortality ration ➤ Improved nutritional status among children and women ➤ Reduced total fertility rate ➤ Reduced household health expenditure, especially among the poor ➤ More effective and efficient health system
Strategies	
<i>Health service delivery</i> 1. Further improve coverage and access to health services especially for the poor and other vulnerable groups through planning the location of health facilities. 2. Strengthen the delivery of quality basic health services through health centers based upon minimum package of activities. 3. Strengthen the delivery of quality care, especially for obstetric and pediatric care, in all hospitals through measures such as the complementary package of activities. Behavioral change 4 Change for the better the attitudes of health providers sector wide to effectively communicate with consumers especially regarding the needs of the poor through sensitization and building interpersonal communication skills	<i>Quality improvement</i> 5. Introduce and develop a culture of quality in public health, service delivery and their management through the use of Ministry of Health quality standards. <i>Human resource development</i> 6. Increase the number of midwives through basic training and strengthen the capacity and skills of midwives already trained through continuing education. <i>Health financing</i> 7. Ensure regular and adequate flow of funds to the health sector especially for service delivery through advocacy to increase resources and strengthening financial management. <i>Institutional development</i> 8. Organizational and management reform of structures, systems and procedures in the Ministry of Health to respond effectively to change.

3.18 The central innovation of the HSSP is to supplant a strategy based on coverage by facilities with one based on outputs and outcomes. The indicators proposed for monitoring each strategy are intended to be based largely on existing monitoring systems, and include a range of both general activity indicators, such as contacts per capita, as well as more specific indicators. Some indicators are broken down by income group, and the financing indicators emphasize the proportion of the poor given exemptions from user charges. Targets for achievement have also been developed for each strategy. Moreover, the HSSP forms the basis for the sector wide management (SWiM) approach.

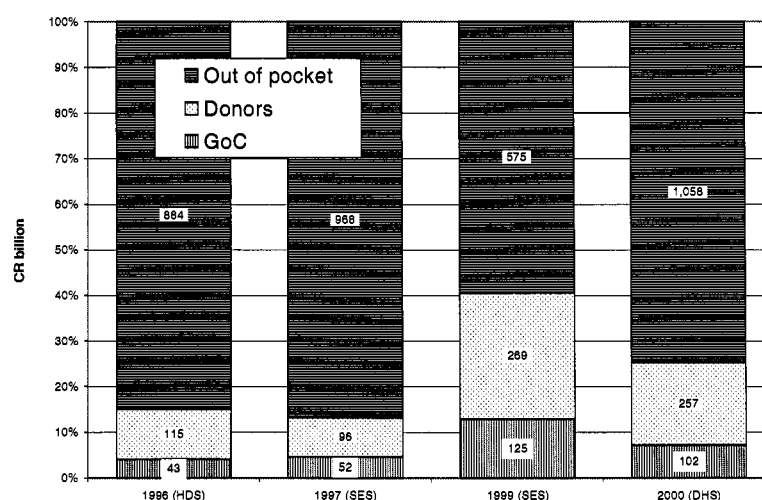
3.19 Further work needs to be undertaken, however, to cost and operationalize the HSSP. First, MOH needs to link the strategies in the plan to the program areas used in the MTEF (these are based mainly on budget management centers, or BMCs). Both indicators and costs must be related to sector programs. Second, operational plans for each program area need to be developed, based on the new planning manual. This is a substantial and challenging undertaking since it requires that program area managers identify key activities, costs, and performance indicators. Third, over the medium to long term, the central budget process will have to be revised so that it supports the disbursement and monitoring requirements of a program budget approach (PAP, discussed in Chapter 4, has given MOH some experience in program-based

budgeting). The HSSP is a major step forward in that it provides a strategic framework for the sector and underpins both the nascent MTEF and the SWiM.

Health sector expenditures

3.20 The health sector is financed from three main sources: government revenue, donors and private, mainly out-of-pocket, contributions. There is a significant degree of uncertainty about the total level of funding derived from each source.¹⁹ The majority of health care spending is made through out-of-pocket payments in public and private sector facilities. Most of the household surveys indicate a figure of between 75 and 85 percent (US\$ 20-30 per capita) of total funding (see Figure 3.1).

Figure 3.1: Health Sector Funding by Source of Finance



3.21 Total Government funding increased from CR 26.7 billion in 1995 to a budgeted CR 147.7 billion in the 2002 budget, a 450 percent increase (280 percent in real terms). This implies a threefold increase in dollars per capita, from just over one to a budget of around three dollars in 2002 (see Table 3.3).

3.22 There are three key concerns from an economic perspective: (1) allocations for maintenance are inadequate; (2) the share of wages to recurrent spending has decreased significantly; and (3) the share of operating costs (excluding drugs and supplies) has risen consistently (see Table 3.3). The problem on the capital-recurrent side is that the capital and recurrent funding processes are totally separate. Capital spending is treated as a “free-good” in the sense that no obligation is placed on MOH to maintain and eventually replace items. In 2001 salaries accounted for about 10 percent of recurrent spending, one of the lowest shares in the world. By comparison, in Vietnam the share is 23 percent, while in Bangladesh the share is 45 percent (World Bank, 2001, HEU and MAU, 2001). At the same time the rising share of (non-drug) operating costs raises concerns about the efficiency of spending.

¹⁹ Sources of information on private spending: HDS – Household Demand Survey (1996), CSES – Socio-economic survey (1997 & 1999), and DHS – Demographic and Health Survey (2000).

Table 3.3: RGC Spending by Economic Classification and Level of Spending
(CR million)

Chapter	Actual						Budget			
	1998	%	1999	%	2000	%	2001	%	2002	%
10 Salaries	10,266	22.5	12,027	9.6	13,650	13.4	12,871	9.7	17,630	11.9
11 Operating costs (excluding drugs)	11,794	25.9	30,557	24.4	40,863	40.2	26,799	20.2	45,398	30.7
11 Drug & medical supplies	20,506	45.0	28,315	22.7	37,710	37.1	44,783	33.7	55,007	37.2
13 Special Programs (ADD & PAP)	440	1.0	3,000	2.4	8,445	8.3	38,707	29.1	28,000	19.0
31 Social allowances	546	1.2	649	0.5	752	0.7	606	0.5	1,640	1.1
32 International Organizations		0.0	175	0.1	16	0.0	20	0.0	25	0.0
Recurrent expenditure	43,552	95.5	74,723	59.8	101,436	99.8	123,786	93.2	147,000	100.0
50.01 Investment-construction & equipment	672	1.5	50,274	40.2	241	0.2	7,099	5.3	-	0.0
10.02 Investment-counterpart contribution to loans	1,383	3.0	-	0.0	-	0.0	1,929	1.5	-	0.0
Capital expenditure	2,055	4.5	50,274	40.2	241	0.2	9,029	6.8	-	0.0
Total	45,607	100	124,997	100	101,677	100	132,815	100	147,000	100
Central level (incl. national programs)	18,251	40.0	35,139	47.0	44,905	44.3	56,718	43.7	64,502	-
Province level	27,349	60.0	39,584	53.0	56,531	55.7	73,158	56.3	83,198	-
Total (recurrent only)	45,600	100.0	74,723	100.0	101,436	100.0	129,876	100.0	-	-
Per capita (CR)	4,036	-	10,776	-	8,690	-	11,075	-	12,017	-
Per capita (US\$)	1.09	-	2.84	-	2.29	-	2.84	-	3.00	-
Salaries as proportion of recurrent spending	-	23.6	-	16.1	-	13.5	-	10.4	-	11.9

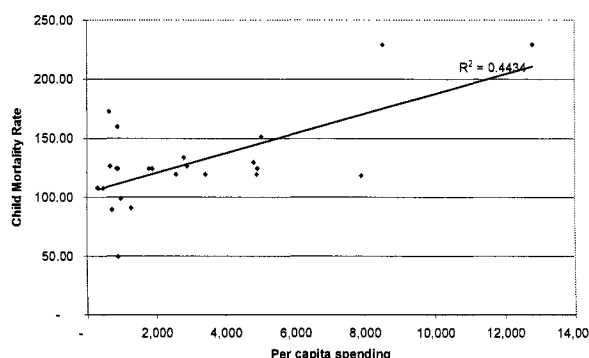
Source: Ministry of Health expenditure & budget books, 1998-2002

Note: Chapter 11 operating costs include utilities, office supplies, maintenance, training, patient food and staff expenses.

funding, at least the proportion that can be allocated to individual provinces, is included, expenditures appear less unequal with the coefficient of variation for 2001 falling to 0.42 (from 0.89) and the min/max ratio increasing to 14 percent. This suggests that donor funding tends to favor provinces with larger populations.

3.27 It would be surprising, given the capacity-based system of allocation, if there were a strong link between provincial deprivation and expenditures. There appeared to be quite a strong relationship between child mortality (DHS, 2000) and donor allocations, indicating some positive targeting of provinces with poorer health status (Figure 3.3). It should be observed, however, that only around 25 percent of donor spending could be directly attributed to individual provinces from existing records so the descriptive conclusions can only be tentative.

Figure 3.3: Donor Funding and Child Mortality by Province



3.28 User fees also contribute a significant amount toward health care spending, though revenue from user fees obtained at the facility level vary considerably. Based on reports from provinces and central facilities, user charges amounted to about CR 5.3 billion in 2001 (US\$ 1.3 million). This represents 4.5 percent of total government spending on health and only 0.9 percent of total household spending on health care. However, this only represents around 2.8 percent of what households report they spend in public health facilities. For selected schemes for which data is available, user fees account for 15 to 60 percent of total facility income. Figures quoted in a series of reports on health financing schemes in provinces consistently provide much higher estimates of user fee revenue than do reports available at MOH. In some areas comparison of user charge evaluations and MOH figures suggest that the true figure for charges might be up to four times the reported figures.

Table 3.4: Reported User Charges in Public Facilities, 1998-2001, CR millions

	1998	1999	2001
Central level	2,238	2,641	3,396
Provincial level	1,206	1,071	1,932
Total	3,444	3,712	5,327
Percent government spending	7.6%	3.0%	4.5%
Percent of private expenditure		0.6%	0.9%
Percent private spending in public facilities			2.8%

Source: Health Economics Task Force, Department of Planning & Information, MOH

3.29 The regulations regarding user fee expenditure allow facilities to retain 99 percent of collections (49 percent is allocated to staff remuneration and 50 percent for operational use). The remaining 1 percent is deposited in the Treasury, which is supposed to ensure that a report of fees is received at the central level. User charges are appreciated by local authorities who view them as an important way of ensuring supplies and attendance of health staff. Facilities generally report that user fees have led to a general increase in activity.²² Of considerable

²² In Takeo, for example, outpatient consultations fell although specialized consultations increased (De Loof, Bonnet et al. 2001). Inpatient admissions also increased. In Sotnikum, where there is strong appreciation by patients for

importance is that a previously unofficial practice is made official and regular. Price lists posted in facilities increase transparency and reduce the need for patients to shop around for supplies needed for their treatment.

3.30 The concern is that, unless adequate provision is made, user fees impact disproportionately on the poor and undermine their ability to access care. The concerns are not principally about whether charges should exist, since the alternative seems to be an unregulated unofficial system (though it should be noted that many public sector employees are involved in the private provision of health services, which results, in part, from the civil service pay problems discussed in Chapter 5). In health centers the very modest charges and willingness to grant exemptions may minimize the negative impact of charges. Even in areas with exemption mechanisms, however, there is evidence that user charges cause destitution. Poor people are often forced to sell possessions or even land to pay for public health care, particularly in rural areas (Wilkinson, Holloway et al. 2001). This finding is supported by the DHS which found that more than 26 percent of patients paying for health care obtained the money by borrowing or selling assets.

3.31 Health financing schemes must make provision for the poorest, by establishing equity funds, but the precise design is left up to the implementing locality and actual practice varies widely (Bitran, Espinosa, et al. 2002). In Takeo, for example, an asset questionnaire, that identifies key factors that differentiate the poor from the non-poor, is used.²³ Exemptions are financed from user fee income and a maximum level of exemptions required to sustain the scheme are computed to ensure affordability. Provision for exemptions range from 10 to 22 percent in the evaluations recorded. Given that the poverty rate, according to the SES 1997, exceeds 36 percent, this provision is probably insufficient even in the more generous schemes (Bitran, Espinosa et al. 2002).

3.32 A second concern with user charges is that they may distort the priorities of health staff toward health care that makes money rather than what is most effective for patients. It is unclear from the evaluations whether user charges are leading to a reduced emphasis on prevention. It could certainly be argued, however, that unofficial charges also distort priorities, and if official systems are established correctly then the distortion can be lessened.

Health sector outputs and outcomes

3.33 During the last five years there have been important achievements in the health sector. Polio has been eradicated and the levels of other communicable diseases, while still high, have shown significant decline. The number of malaria-related deaths has fallen while the numbers of people (15 to 49) living with HIV has declined consistently for the last three years from a peak of 4.04 percent to the current estimate of 2.8 percent (see Table 3.5). This downward trend may be at least partly due to the significant increase in condom use achieved within high risk groups. Rates of condom use among sex worker, for example, now exceed 90 percent, up from only 16 percent in 1996.

3.34 Physical coverage of the population by the public health system has also expanded. Delivery care at health centers or hospitals has increased but is still below 10 percent of expected deliveries (see Annex A Table A13). At the same time MOH experimented with different modalities of service delivery and its instructive experience has gained international attention (see Box 3.2).

guaranteed opening hours and drugs supplies, utilization shows no decline and in some cases a positive trend is reported (Van Damme and Meessen 2001).

²³ Includes house roof of grass or leaves, no furniture, no television, no transport, fewer than 3 farm animals.

Table 3.5: Trends in Selected Utilization, Access and Health Status Indicators

	1997	1998	1999	2000	2001	Provincial variation
Number of contacts per year (public facilities)	0.33	0.31	0.29	0.31	0.35	0.09 to 0.9
Bed occupancy (not all facilities)	45%	45%	47%	51%	51%	9.8% to 122%
Prenatal coverage	33%	30%	36%	41%	43.0%	5.6% to 65.2%
Delivery coverage (health center/hospital as percent of expected deliveries)	6.9%	5.7%	7.7%	9.2%	8.6%	0.01% to 9.2%
Measles coverage	68%	63%	63%	69%	72%	26.6% to 89.9%
Malaria – cases per 100,000 population	1,549	1,246	1,199	1,104	1,114	
Malaria case fatality rate	0.51%	0.44%	0.64%	0.47%	0.19%	
Adult HIV prevalence	4.55%	3.46%	3.2%	2.8%		

Source: National Health Statistics Report, Ministry of Health, 2001; Report of National Center for Parasitology Entomology and Malaria Control, 2001.

3.35 Despite these achievements, progress in other areas has lagged, and health conditions in Cambodia continue to be poor relative to other Asian countries. Infant mortality has fallen to 86 in 2001 from 95 in 1997, slightly lower than in Lao PDR but three times the rate in Vietnam. One of the reasons is that access to services remains low and uneven, as considerable provincial variations are apparent. The number of contacts with public facilities varies from 0.06 (Kok Kong) to 0.79 (Monduliri). Based on MOH data for 2002, only about 54 percent of the population lives within 10 kilometers of basic public health services

Box 3.2: The Cambodian Experience with Contracting for Service Delivery

Some attempt to harness the management capacity and incentives present in the non-government sector was made through a project supported by ADB in 1998 (Keller and Schwartz 2001). This project envisaged two approaches to contracting: (a) a contracting-out approach (in 2 districts), in which the management of all district health services, including procurement, equipment purchase and staff employment, was contracted to a non-government agency; and (b) a contracting-in approach (in 3 districts), in which non-government contractors were hired to provide management expertise while responsibility over management was kept with civil servants. Contractors were given a budget to provide a full range of services. In addition, four similar “control” areas were selected to provide a basis for on-going comparison with the intervention areas. In order to provide a fair basis for comparison, budgets in control areas were also boosted to a comparable level.

An evaluation was undertaken in 2001 at a relatively early stage in implementation. A baseline survey (conducted prior to implementation) was compared with indicators from a post-implementation survey. The evaluation found that while the cost per capita in districts that contracted out and, to a lesser extent, that contracted in, was considerably higher than in control areas, total costs, including those incurred by patients, were reduced in the contracting areas (see also Box 5.1). In addition, activities as measured by, for example, total number of patients, number of immunizations and attended deliveries, were found to be considerably higher. There was, however, also much variation between districts with similar interventions. So, for example, while the average increase in the number of facility deliveries was higher in contracting-in and -out districts, in two out of five contracting districts there was no significant difference (while one of the control areas registered the third highest increase). A key finding of the evaluation, however, was that in contracting districts *health care spending by the poorest declined suggesting that the improvement in access helped to reduce both physical and financial barriers to obtaining health services.*

The experience is of considerable interest in assessing future scope for non-bureaucratic and non-government methods of contracting. Some more work may be required in assessing what features contributed to the greater success of contracting in certain districts. An element of self-selection is inevitable, however carefully districts are chosen, where districts that have structures that are initially stronger than others are chosen to participate. Extending the experience requires both greater resources and a greater appreciation of the pre-requisites that are required for the contracting to be successful.

Source: “Contracting and Similar Experiences in Health in Cambodia,” Peter Feenstra/Medicam, December 2001.

3.36 The 1996 health coverage plan sought to concentrate funding on two levels: health centers and district referral hospitals, which are based in 67 operational districts (OD). The plan envisaged strengthening the current system of health services so that all health centers could provide the minimum package of activities (MPA) while all district hospitals would provide a complementary package of activities (CPA).²⁴ However, only a minority of hospitals are able to provide the CPA. According to the 2002 budget book, only 40 percent of 48 provincial and district hospitals were able to provide the CPA while 82 percent of 991 health centers were able to provide the MPA. Coverage of the minimum standard is thus incomplete.

3.37 The major outcome-related concern is that the incidence of benefits is skewed away from the poor and toward middle income and wealthy groups. It is clear from Table 3.6, for example, that use of services, as reflected in immunization rates, trained delivery, and medical attention for disease, is higher for rich rural and urban residents compared to the rural poor by a wide margin. Given that many diseases such as ARI and diarrhea are likely to impact more heavily on the poor, the actual difference in use relative to need is even larger. Likewise, health status indicators are much worse for the poorest groups. Infant mortality, for example, of the poorest group is more than double that of the richest.

Table 3.6: Use of Health Facilities, Knowledge of Health and Health Status by Socio-Economic Status^{a/}

	Rural poorest	Rural rich	Urban poor	Urban rich	Poorest women
Immunization – measles	45%	85%	(..)	78%	41%
Diarrhea - ORT use	11%	44%	(..)	41%	12%
ARI - seen medically	31%	52%	(..)	53%	25%
Severely underweight	16%	6%	(..)	6%	18%
Antenatal visits – trained person	14%	56 %	20%	71%	-
Delivery – attended by medically trained	14%	75%	23%	88%	-
Use of modern contraceptive	10%	22%	12%	24%	-
Knowledge of HIV/AIDS	59%	89%	56%	93%	-
Infant mortality rate	108.70	58.30	(..)	41.10	94.10

Source: Adapted from DHS, 2000, Macro International by Livia Montana

^{a/} (..) Indicates large sampling error due to small number of cases.

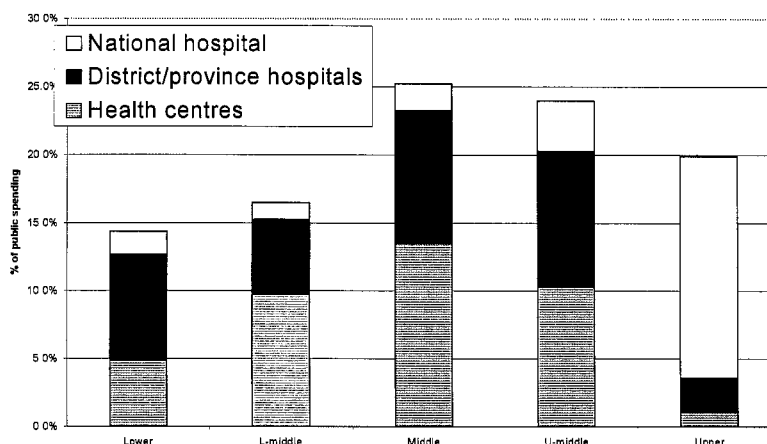
3.38 The analysis indicates that whereas the lowest income quintile consumes 13 percent of the resources, the top quintile uses almost 20 percent (Figure 3.3). Put differently, the bottom 40 percent of the population consumes only about 30 percent of public health spending. This disparity is even greater if the relative health need of the poor is considered to be greater than that of the rich. Inequality in resource distribution is most evident for the national facilities, where relatively wealthy urban Cambodians make most use of these services. By contrast, district hospitals appear to provide the greatest benefit to the poorest group.

3.39 These results, however, should be placed in context. Although they indicate some pro-rich (or at least pro-middle income) bias, this has been a common finding in a number of developing countries. In fact the concentration index (which indicates the overall bias to the rich or poor in distribution of benefits) indicates that the distribution in Cambodia is less pro-rich than

²⁴ The MPA comprises most essential first level services including initial consultation and primary diagnosis, emergency first aid, chronic disease care, routine child health, maternal care including normal delivery and birth-spacing advice, health education and onward referral. The CPA comprises consultation and advanced diagnosis for referred patients, medical and surgical emergencies, hospitalization and dentistry (Ministry of Health, Health Center Manual, Phnom Penh, 1997).

that found in Vietnam, Bulgaria, and Ghana, and similar to the distribution in Bangladesh, but more pro-rich than in Sri Lanka (Demery 2000).²⁵

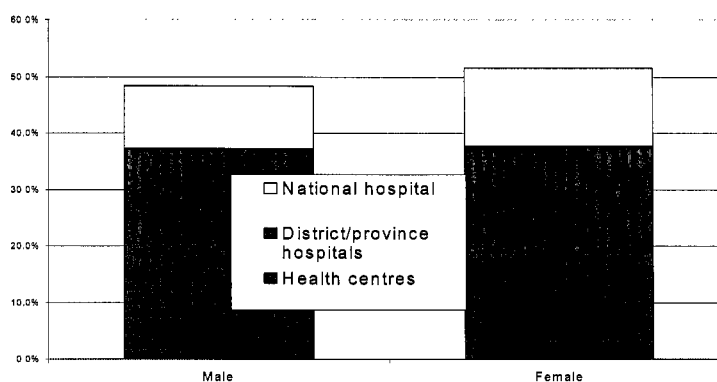
Figure 3.3: Benefits Incidence Consumption Group
(RGC Spending)



Source: Computed from Government data and CSES data on utilization (National Institute of Statistics, 1999).

3.40 Resources appear to be more or less equally distributed between men and women (Figure 3.4). The small difference almost exactly mirrors the differences in the relative size of each group. It is, however, usual for the health needs of women to be greater than those of men. If reproductive health care, which is predominantly used by women, is subtracted from utilization and spending it is likely that the benefits incidence would be shown to favor men. Repeating the analysis for men and women outside the 15-44 age group, benefits favor men over women (26 to 24 percent of spending). No difference between men and women of different income groups was found (see Box 3.3 for a discussion of barriers to access for women).

Figure 3.4: Gender Benefits Incidence of Government Spending



Source: Computed from Government data and CSES data on utilization (National Institute of Statistics 1999).

3.41 This analysis reinforces the need not only to improve health indicators on average, by improving the overall management of the sector, but also to target interventions to the

²⁵ Defined as the area between the benefits concentration curve and the 45 degree line of equality. A positive index indicates a pro-rich bias whereas a negative index indicates a pro-poor bias. The figures for Vietnam, Bulgaria, Ghana, Bangladesh and Sri Lanka are respectively 0.16, 0.126, 0.192, 0.073, and -0.006. The comparable figure in Cambodia is 0.074.

poorest groups where low cost interventions could have most impact. Fully understanding the reasons for this distribution requires an analysis of the multiple determinants of health sector use, which remains an important areas for future investigation. A preliminary multivariate investigation, based on the 1999 data, suggests that location of facility is extremely important both in determining how long people wait before consulting a practitioner in the event of illness and in determining which facility is chosen for treatment. It is likely, therefore, that choice of health sector or hospital is strongly determined by population concentration.

Box 3.3: Women and Service Provision I: Barriers to Access in Health

Though MOH's MPA and CPA both have a strong focus on the health care needs of mothers and children, according to the Cambodia Demographic and Health survey, more than 90 percent of women reported having one or more problems in accessing health care for themselves. The most common problem identified was inability to pay for health care (88 percent of women surveyed). Distance to health facility and difficulty with transportation were each identified by more than 40 percent of women surveyed. As in the case of education, international evidence shows that utilization of health care services by girls and women is more price sensitive than utilization by boys and men.¹ For this reason, changes in out-of-pocket expenses, through user fees or health equity funds, are likely to have different effects on women than on men.

Problems in access result in serious health problems for women and children and have a major impact on the capacity of the health system to deliver services effectively. Some of the more serious problems underline the importance of ensuring access: Iodine deficiency, causing miscarriage, premature birth, and increased child mortality, is high. Sixty-six percent of pregnant women and 87 percent of children under one year are anemic. Nationwide, only 2.4 percent of women had iron supplementation from any source during pregnancy. Only 38 percent of pregnancies received antenatal care from trained health personnel. Only 10 percent of births take place in health facilities. Thirty-two percent of births are assisted by trained medical staff (midwife, nurse or doctor). Most commonly, births are assisted by Traditional Birth Attendants (66 percent of births).

Another important problem, access to contraceptive methods, is an important determinant of the HIV/AIDS epidemic. There is a large unmet demand for contraceptive methods. 57 percent of women wish to use contraception, but only 24 percent of women currently using contraceptive methods. Of these, only 19 percent are using modern methods of contraception. This takes on increasing importance as the epidemic moves increasingly beyond sex workers and their clients and into the general population.

The MOH provincial health care system (health clinics and referral hospitals) is a minor players in HIV/AIDS activities, accounting for only 10 percent of spending on HIV/AIDS and doing very little of the condom distribution (less than 5 percent). Going forward, there would seem to be considerable scope for promotion of condoms as a means of contraception. Emphasis on condoms for contraception may be useful within the context of marriage and other long term relationships as a way to avoid directly discussing HIV/AIDS transmission with its implication of distrust and infidelity. To date, there has been little movement in this direction, however.

The principal constraint to improved service provision in the area of HIV/AIDS will not be budget but rather will be the ability of NCHADS and the provincial health systems to work together and for each to change their approach: NCHADS will have to develop messages relevant to married couples and the MOH provincial health system will have to be willing to emphasize condoms, rather than other means of contraception.

3.42 One possible response is to craft a pro-poor strategy that requires resources to be channeled to modes of service delivery used relatively more by the poor. This suggests greater emphasis of funding on peripheral rather than national level facilities. This appears to be envisaged by the HSSP and community delivery in particular could help to reach some of the groups currently not accessing the health system. The incidence analysis suggests that the poor utilize health centers and clinics less than middle income groups, thus monitoring the effect of improved targeting will be particularly important. It is, however, unlikely to be efficient to attempt to provide all services through operational districts or health centers.

3.43 **A second, complementary, approach would be to help the poor obtain essential care when necessary in larger facilities in the provincial or national capital.** Demand side funding, targeted not only at reducing the burden of facility charges on the poor, but also of other expenses, such as transport, may have a role to play in reducing the barriers to accessing services. This is likely to be a particularly important issue in more remote provinces with less developed transport networks. There may be a role here for targeting equity funds at these areas in particular and permitting their use not only for user charge exemptions but to contribute toward other costs of receiving services.

EDUCATION

- *Policy and Planning:* There has been major progress in sector planning, which is well-developed and effectively linked to the budget and nascent MTEF.
- *Expenditures:* There has been a significant increase in Government funding over the past few years, doubling as a share of GDP, and the major share of spending is allocated to primary education. In economic terms there has been a shift in favor of recurrent spending vis-à-vis capital expenditures, but the wage share of recurrent spending has dropped to unsustainably low levels, despite some correction in 2002.
- *Outputs and Outcomes:* Since 1999 steady progress has been made in expanding educational opportunities with total enrolment growing. Moreover, enrolment growth has been concentrated among the poor. Repetition rates also fell. The focus on primary education means that sector spending has become increasingly pro-poor. At the same time the subsidies provided by the RGC are pro-poor, and, if implemented as planned, will reduce out-of-pocket costs significantly. However, net enrolment ratios and the completion rate at the primary level are the lowest in the region. Moreover, quality continues to be a concern.

Sector policy and planning

3.44 **The education sector has developed a high quality planning process, composed of two stages, that is linked to the budget process and the nascent MTEF.** The 2001 Education Strategy Paper (ESP) puts forth the sector's main goals, while the Education Sector Strategic Plan (ESSP) describes annual plans and activities for operationalizing the ESP (see Table 3.7). The ESSP is a rolling plan that is reviewed annually by the MOEYS together with development partners.

3.45 **The strategies enumerated in the ESP/ESSP give rise to twelve priority programs funded through the Priority Action Program (PAP).**²⁶ Moreover, these programs have been costed by MOEYS and linked to the MTEF. The program cost is estimated to require RGC recurrent spending volumes to triple between 2000-2005 (from 0.9 percent to 2.9 percent of GDP, and from 10.0 percent to 21.8 percent of total recurrent spending). The capital investment cost of the ESSP is estimated at US\$ 120 million over the five year period 2001-2005. The indicative MTEF ceilings, while they do not provide full coverage of costs as estimated by MOEYS, do indicate provision for over 90 percent of ESP costs. Thus, the education sector has made enormous headway in improving its planning process, linking it effectively to the annual budget and the MTEF, and introducing elements of program-based budgeting. All of this should continue to improve the linkage between plans and expenditures and thereby strengthen the poverty focus on sectoral spending.

²⁶ See Table A12 in Annex A for a comparison of ESP program costs and indicative MTEF allocations. Two additional priority programs are funded from the capital budget.

Table 3.7: The Education Sector Strategy Paper and Strategic Plan, 2001-2005

Goals	Outcomes
1. Achieve the Education For All (EFA) objective of nine years of quality basic education (grades 1-9) for all children by 2015, delivered in the most efficient manner possible	<i>Equitable Access to Services</i> ➤ Achieve a 95 percent net enrolment rate in basic education (primary and lower secondary) by 2015 with a 2005 target of 95 percent in primary, 50 percent in lower secondary, and 20 percent in upper secondary education, with girls and rural students increasing their share of total enrolment at all levels of education
2. Expand opportunities for post-basic education through public/private partnerships	➤ Double the enrolment in post-secondary education and increase the private share to 85 percent.
Achieve greater equity through appropriate financing tools	<i>Improved Quality and Efficiency of Service Delivery</i> ➤ Increase the pass rate from 50 percent to 95 percent
Strategies	
<i>Equitable Access to Services</i>	
1. Reduce physical constraints and the direct and indirect costs of education to parents (i.e., lower their share of total recurrent expenditures to 18 percent at the primary level, or from roughly CR 40,000 to 26,000 per child) by prioritizing capital investments accordingly, eliminating formal and informal fees in basic education, providing waivers and scholarships for the poorest in upper levels of education, and providing operational resources to all public education establishments to compensate for the loss of fee income, cover maintenance costs, and provide materials and supplies for all students.	
<i>Improved Quality and Efficiency of Service Delivery</i>	
2. Reduce repetition, enhance capacity of lower levels to implement school operational budgets transparently, and maintain sustained increases in recurrent spending.	
<i>Institutional Development and Capacity Building</i>	
3. Provide continuous teacher education, develop and improve core instruction materials, and strengthen the monitoring system.	

Education sector expenditures

3.46 **The education sector is financed from three main sources: the Government budget, donors, and out-of-pocket, contributions.** Government expenditure in education only accounts for about half of total sectoral spending, while 35 percent is sourced from parental contributions, and the remaining 15 percent from external project financing (see Table 3.8).^{27,28} Total planned expenditure on education in 2002, all sources combined, is estimated at approximately 4 percent of GDP, or about CR 45,000 per capita (US\$ 11 per capita).

3.47 **Significant shifts in the level and composition of spending took place over the past few years.** These shifts reflect commitments to increase domestic recurrent education expenditure, and particularly the non-wage share. Between 1997 and 2000, RGC expenditure on education doubled in nominal terms (from CR 86 billion to 170 billion), and is projected to

²⁷ As is the case in Cambodia generally, data caveats are in order. Government expenditure by level of education is difficult to estimate and depends on the analyst's assumptions. The MOEYS budget is structured into four sections: General Education, Tertiary Education, Youth and Sports, and Provincial. Each section has four main chapters: Salaries (Chapter 10), Operations and Maintenance (Chapter 11), PAP (Chapter 13), and subsidies for scholarships (Chapter 31).

²⁸ Capital expenditure reported in budget returns by the MEF captures only RGC expenditure made through the budget. In education, this typically represents RGC counterpart contributions to externally financed projects. See Chapter 4 for further discussion of the problems with external financing.

increase to 290 billion in 2002 and 337 billion in 2003. As a share of GDP, education expenditure more than doubled from 0.9 percent to 2 percent between 1997-2002.

Table 3.8: Estimated Total Expenditure on Education, 1997-2002 ^{a/}

	1997	1999	2000	2001	2002 b/
Total Education, Capital + Recurrent (CR millions) ^{a/}	401,251	496,111	503,826	526,932	576,338
As a percentage of GDP	4.4%	3.9%	3.9%	3.9%	4.0%
Per Capita (in CR)	36,551	41,371	40,199	40,233	42,937
Per Capita (in US\$) ^{b/}	12	11	10	10	11
Percentage Government budget	21%	31%	34%	44%	50%
Percentage Private	37%	38%	35%	35%	34%
Percentage External (project support)	41%	31%	31%	22%	16%
Total Recurrent Expenditure (Govt. + Private in CR millions) ^{c/}	231,908	337,435	341,441	394,948	481,638
Total Govt. Exp. (Capital + Recurrent in CR millions)	86,246	155,732	169,860	229,653	290,200
Percentage GDP	0.9%	1.2%	1.3%	1.7%	2.0%
Education share of total Government expenditure	7%	8%	8%	9%	12%
Education expenditure per capita	7,856	12,986	13,553	17,531	21,620
Government Recurrent Expenditure on Education	83,403	149,781	165,815	212,305	286,200
As a pct. of Government education expenditure	58%	68%	68%	75%	84%
As a share of total Government recurrent expenditure	10%	14%	14%	15%	20%

Sources: Expenditure information from 1999 Poverty Assessment for 1997 data and private expenditure, TOFE for 1998-2001 RGC expenditure, Budget Law for 2002 for government expenditure, UNDP and ESSP estimates of external education (project) financing for 1999-2002. Population figures are from the UNFPA projections based on the 1999 population census.

^{a/} Total expenditure excludes private investment expenditure due to lack of information.

^{b/} Expenditure for 2002 is budgeted. Other years are actuals as per the TOFE.

^{c/} The estimated expenditure reduces private expenditure by the increased Government subsidy for fees, books, materials and supplies.

3.48 Externally-financed project expenditure shows a marked downward trend, while RGC recurrent spending shows a sustained upward trend. Between 2000-2002, external project financing declined by 40 percent in nominal terms and is expected to decline further in 2003. Its share of total expenditure fell from 41 percent in 1997 (including private) to 16 percent by 2002. This contributed to a shift in the recurrent-capital ratio from 60:40 in 1997 to an expected ratio of 85:15 in 2002. External financing also played a critical role in this shift through greater budgetary support. While a higher recurrent-capital ratio was essential for the sustainability of investment, and is now more comparable with other countries in the region, the ratio may have grown too much. Planning should be undertaken to ensure an adequate level of capital investment to support sectoral planning for improved coverage.

3.49 Due to increasing allocations and stagnant wages, the share of wages in recurrent spending has dropped considerably. Since the scaling up of the PAP, budget allocations and expenditure on wages have fallen considerably as a share of education recurrent expenditure, from 78 percent in 1997 to only 67 percent in 2002 (see Table 3.9).²⁹ This is low in comparison to developing economies where the wage share ranges between 70-80 percent. Accordingly, the budgeted non-wage share increased from 22 percent to 33 percent of recurrent expenditure, which is high by international standards.

²⁹ According to preliminary expenditure estimates for 2002.

Table 3.9: Distribution of Government Recurrent Expenditure, 1997 - 2002

	1997	1999	2000	2001
<i>Total</i> (CR millions)	83,403	149,781	165,815	212,305
<i>Per Student</i> (CR)	36,8107	61,840	64,286	75,115
<i>Wage</i> (CR millions)	64,766	111,972	121,028	132,088
Percentage of Recurrent Expenditure	78%	75%	73%	62%
<i>Non-Wage</i> (CR millions)	18,637	37,809	44,787	80,217
Chapter 11: Operations & Maintenance	19%	23%	23%	23%
Chapter 13: PAP	0%	0%	2%	13%
Chapters 31,32: Subsidies	3%	2%	3%	2%

Note: The wage/remuneration expenditure under the PAP is classified as wage expenditure.

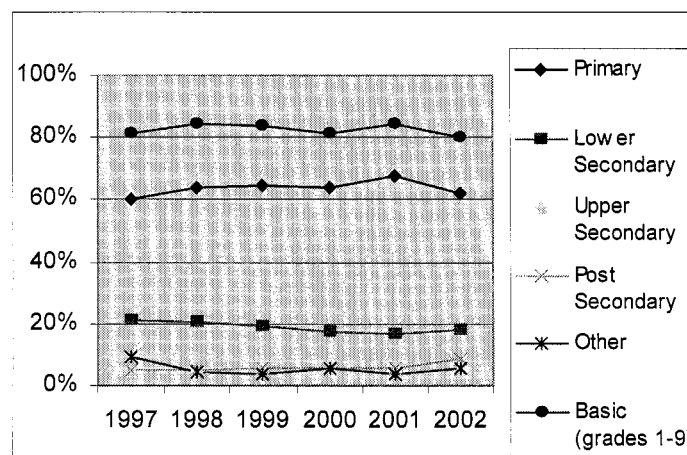
Sources: Expenditure data for 1997 are from World Bank, 1999 Public Expenditure Review. Data for 1999-2001 are from end-of-year MEF outturns. Enrolment data are from the MOEYS annual statistics.

3.50 Between 1997-2002, non-wage expenditure increased seven fold in nominal terms, with increases above 70 percent in 1999, 2001, and 2002. In 1999, this was due to a boost in operations and maintenance (O&M) funding, particularly at the central level. In 2001 and 2002, it was due to the budget increase channeled through PAP, while O&M also continued to increase. By 2002, the composition of non-wage expenditure was 51 percent for PAP, 44 percent for central O&M, and 5 percent for subsidies. The increase was also significant on a per student basis where recurrent expenditure almost doubled in nominal terms, increasing from CR 37,000 to 89,000 per student (US\$ 12-22) with more than half the increase channeled through the PAP.

3.51 Chapter 11 (O&M) continues to represent a large share of the budget given that O&M for schools is financed through the PAP. It is likely that savings can be generated from these expenditures. For example, of total Chapter 11 spending in 2001, 69.7 percent was for sports (matches and utilities), and fully 78.7 percent of the total increase in Chapter 11 (1999-2001) has been allocated to sports. If these data are accurate, these resources should be reallocated to higher priority programs.

3.52 RGC recurrent expenditure by level of education reflects the ESSP priority goal of achieving EFA (see Figure 3.5).³⁰ Over the past five years, on average, 64 percent of education expenditure was for primary education. The share increased over this period from 60 percent to 67 percent in 2001 and fell back to 62 percent in 2002. The share of expenditure allocated to lower secondary education fluctuated with changes in the share allocated to primary education. Together, primary and lower secondary education (or basic education) received between 80-84 percent of RGC recurrent expenditure. The share allocated to basic education is high compared with other countries in the region, and that allocated to upper secondary and tertiary education are quite low. This is illustrative of the priorities set by the RGC, but also of tight resource constraints. However, the MOEYS also spends a relatively high share on "other" education. It would be advisable for MOEYS to reassess the contribution of this category of expenditure to the achievement of ESSP goals.

³⁰ It was not possible to attribute capital expenditure to the different levels of education because most capital expenditure is externally financed through projects.

Figure 3.5 Share of Government Recurrent Expenditure by Level of Education, 1997-2002

Source: Government budget data and MOEYS statistics.

3.53 In 1997, private expenditure on education was on the order of CR 150 billion, with 62 percent of expenditure at the primary level (see Table 3.10). On average parents spent the equivalent of about CR 48,200 (US\$16 at 1997 exchange rates) for a primary student. Expenditure on students in lower secondary, upper secondary and tertiary education were 2.8, 5.5 and 4.4 times higher. Parental expenditure ranged between 65 percent of total recurrent expenditure on primary education to 80 percent in upper secondary education. Tertiary education was the most highly subsidized sector, where parental expenditure covered only 50 percent of the total cost of education.

Table 3.10: Private Recurrent Expenditure, 1997

	Per Student (in CR)				Average		Pct. of Total Recurrent Expenditure
	Private Expenditure (CR million)	Poorest 20%	Richest 20%	National Average	US\$ (1997 exch. rate)	Ratio to Primary	
Total	148,505	25,581	154,046	65,555	16		64
Primary	92,484	23,904	107,500	48,194	12	1	65
Lower Secondary	35,851	51,900	224,337	134,833	34	2.8	67
Upper Secondary	16,214	75,870	341,228	262,911	67	5.5	80
Post Secondary	3,956	0	255,478	210,454	53	4.4	50

Source: Poverty Assessment estimates, 1997.

Education sector outputs and outcomes

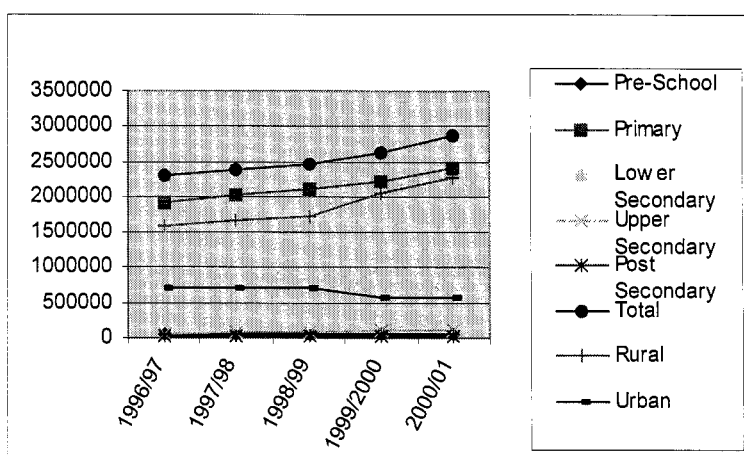
3.54 Faced with difficult initial conditions, Cambodia has made significant progress over the last decade in expanding educational opportunities.³¹ Steady progress has been made,

³¹ The main source of regular data on the education system is the school census conducted annually by the MOEYS, which is fairly consistent over time at broad levels of aggregation. However, trends in breakdowns are sometimes difficult to interpret. Household surveys (in 1997 and 1999) and the population census (in 1998) provide a basis for comparison and provide more reliable information on geographic and other variances.

most particularly since 1999. By 2002, the coverage of primary education reached the equivalent of 123 percent of 6-11 year olds, the highest gross enrolment rate in the region. However, along with Lao PDR, Cambodia has the lowest percentage of 6-11 year olds enrolled in school in the East Asia region, and the lowest percentage of primary students that eventually graduate (See Annex table A14). Coverage at the secondary and tertiary level is far from that of other countries in the region. The gross enrolment in secondary education is only 24 percent, slightly higher than that of Lao PDR, and less than half to one-third that of other countries in the region. The gap is even wider in tertiary education, which enrolls only 1.4 percent of adults aged 19-22.

3.55 As education in Cambodia is predominately publicly provided, the recent increase in public school enrolment is critically important.³² Since 1997, all levels of general education grew at rates more than triple the rate of population growth (see Figure 3.6). On average, primary enrolment grew at 7 percent a year, lower secondary at a slightly lower pace, and upper and post secondary at highest rate of 11 and 13 percent respectively although the starting base is much lower for these levels of education. Most of the increase took place between 1999/00 and 2001/02 coinciding with the scaling up of the ESSP/PAP. Compared with ESP targets, total enrolment by 2002 grew slightly less than planned. Primary grew slightly more, tertiary education significantly more, and secondary education significantly less.³³

Figure 3.6: Enrolment 1996/97-2001/02



Source: MOEYS annual statistics.

3.56 Cambodia now has the highest gross enrolment ratio in the region. By 2001/02, enrolment represented an estimated 124 percent of the school-aged population, up from 105 percent in 1999/00. However, the net enrolment ratio remains among the lowest. At most, an estimated 86 percent of 6-11 year olds attend primary school (although household surveys suggest a much lower share). The difference between the net and gross enrolment ratios, and the widening gap between them over time, is due to an increasing enrollment of over-aged youths in primary school. According to MOEYS data, over-aged youths accounted for an estimated 80 percent of the enrolment increase in primary education since 1999/00. As a share of total primary enrolment, overage youth increased from 15 percent to 30 percent of the total enrolment. This may suggest an important backlog of overage youths who will continue to enter for several years, resulting in high levels of coverage needed over a transitional period of time of probably about 10 years. Or, it may result from inflated enrolments to receive higher operational budgets. It would

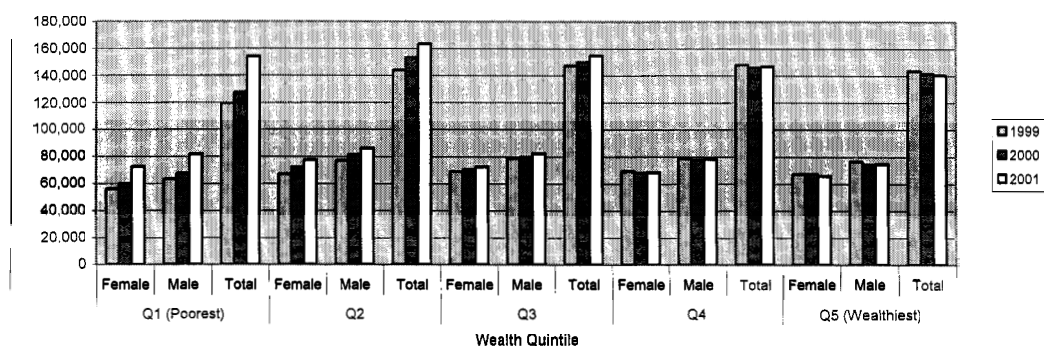
³² The private sector accounts for an estimated 1 percent of enrolment (Poverty Assessment, 1999).

³³ Infrastructure expansion has not kept pace with increased enrolment. To accommodate the enrolment increase, the percentage of schools double shifting increased from 52% to 76% and teacher work loads have intensified.

be advisable for the MOEYS to assess the source of this growth to enable better planning to accommodate over-aged youths.

3.57 Enrolment growth was concentrated among the poor, reducing the enrolment gap between the rich and the poor (see Figure 3.7). Nearly all the growth in primary enrolment, and for a significant share in lower secondary, was in rural areas with the poorest districts registering the highest enrolment increases in primary education, particularly for girls.

Figure 3.7: Grade 1 Enrolment by Community Wealth Quintile, 1999-2001



Source: Royal Government of Cambodia MOEYS, *Poverty Impact Analysis*, 2002.

Note: Quintiles refer to communities ranked according to WFP poverty criteria.

3.58 However, the availability of lower and upper secondary education generally remains limited and out of the reach of the poorest communes. Coverage increased only slightly. Between 1997–2002, the gross enrolment ratio in lower secondary education increased from 27 percent to 34 percent, and from 19 percent to 23 percent in upper secondary. This level of coverage, along with Lao PDR, is among the lowest in the world and only half the coverage found in neighboring countries such as Vietnam.

3.59 A comparison of ESP targets versus actuals shows that targets for primary enrolments have been exceeded, although the net enrolment ratio is lower than expected (see Table 3.11). Double shifting increased much faster than planned, and student-teacher ratios are far above the maximum norm. The rural share of secondary enrolment increased significantly and student-teacher ratios are increasing marginally, although secondary enrolment grew less than expected, and student-teacher ratios are still very low.

3.60 While the Government has made substantial progress on certain aspects of coverage and efficiency, the most impressive result is the increased pro-poor focus of spending. A significantly greater amount of public spending benefits the poor in 2002 as compared with 1997 (see Table 3.12), as recommended by the 1999 PER (see Annex C for a complete discussion of progress made on expenditure policy since the 1999 PER). In 1997, the poorest 40 percent of the population received 42 percent of expenditure on primary education, but only 20 percent, 8 percent and 2 percent of public expenditure on lower secondary, upper secondary and post-secondary education, respectively. Increased subsidies have made education spending evidently more pro-poor. In 2002, if the ESSP has disbursed as planned, the poorest 40 percent of the population would receive 39 percent of total education expenditure, and 50 percent at the primary level. The poorest, however, continue to benefit from only a small share of public subsidies on secondary and post-secondary education, though the incidence of benefits at the lower secondary level also improved from a pro-poor perspective.

Table 3.11: ESP Targets Compared with Actuals

	ESP Targets				Actual	
	2001	2002	2005	1997	2001	2002
Total Enrolment	2,781,151	2,989,898	3,528,934	2,310,161	2,746,473	2,805,091
Primary	2,289,007	2,385,703	2,388,554	2,310,161	2,408,109	2,408,109
Net Enrolment rate			95%	83%	99%	86%
Progression	.62-.8		0.9			
Teaching posts required from 1999 for S:T ratio 50:1	1761	2014	-1333		3494	6455
Pct. Schools Double Shifting		20%	20%	52%	69%	76%
Pupil teacher ratio		48	48	44	53	57
Lower Secondary	373,842	468,837	846,913	265,895	233,278	283,578
Net Enrolment rate		25%	50%	26%	27%	26%
Pct. Rural participation	16%	20%	45%	42%	67%	69%
Percentage girls			45%	37%	37%	39%
Double shift		30%	50%	29%	35%	43%
Student: Teacher Ratio		20	26	19	20	22
Upper Secondary	118,302	135,358	293,467	61,671	105,086	113,404
Net	9%	10%	20%	7%	10%	8%
Percentage Rural				13%	44%	47%
Percentage Girls			40%	35%	32%	32%
Student-Teacher Ratio	23	26	28			
TVET, PTTC, HE, RTTC	22,910	24,193	27,520	18,796	29,612	33,712

Source: Targets - ESP 2001. Actuals - MOEYS annual education statistics.

Table 3.12: Share of Education Subsidy Received by Income Quintile

Quintile:	I	II	III	IV	V	
Percentage of Public Subsidy Using 1997 Enrolment Share						
Primary	21%	21%	21%	20%	17%	100%
Lower Secondary	8%	12%	19%	23%	38%	100%
Upper Secondary	4%	4%	14%	21%	56%	100%
Post-Secondary	2%	0%	6%	15%	76%	100%
Percentage of Government Subsidy Received, 2002 estimate						
Total	19%	20%	19%	19%	23%	100%
Primary	25%	25%	21%	17%	12%	100%
Lower Secondary	11%	14%	19%	22%	34%	100%
Upper Secondary	7%	7%	13%	26%	46%	100%
Post-Secondary	1%	0%	12%	22%	65%	100%

Note: The estimate of the subsidy capture for 2002 assumes that the enrolment trend observed in 2001 (i.e. the enrolment increase primarily reflected increased enrolment of children from the poorest households) would continue into 2002. Enrolment of other income quintiles is capped at 100 percent net.

3.61 These results are largely a function of the share of enrolment by income quintile, as the poorest quintiles represent a larger share of enrolment at the primary level than the wealthier quintiles. However, the wealthiest 40 percent of the population comprises 61 percent of enrolment in lower secondary education, 77 percent of enrolment in upper secondary education and 91 percent of enrolment in tertiary education. Given these distributions, subsidies to primary education, which are a fundamental element of the Government's strategy, and particularly for

fees, supplies, books and materials, would be strongly pro-poor. Increased subsidies in secondary and tertiary education would increase the amount of public funding captured by the wealthiest, and particularly Phnom Penh residents, and thus would be largely undesirable, unless they were specifically targeted to the poor.

3.62 The development of more effective financing mechanisms to lower the costs of education by providing subsidies is likely to have a major impact (coupled with the waiver of the school enrolment fee and the banning of informal fees).³⁴ According to current estimates, the private share of the recurrent cost per student would fall from 66 percent to 41 percent (and Government's share would increase accordingly). The impact of the increased subsidy would be greatest in the case of primary education, where private costs would fall from 65 percent to just 37 percent of the total. The families of primary school children would continue to support the costs of uniforms, food and transport. The per student PAP allocation, estimated to be CR 13,500 in 2002 for primary students, should be sufficient to substitute for what the poor are now spending for fees, books, materials and supplies.

3.63 The increased subsidy would be less significant at other levels of education—with the exception of higher education, which, due to a combination of PAP and other subsidies, is more highly subsidized than other levels. The planned new subsidies in higher education would further reduce the private share of per-student costs from 50 percent to just 24 percent. Cambodia's poorest families benefit little from public subsidies in higher education, given that their enrolment at this level is so low. However, total enrolment in tertiary education in Cambodia is among the lowest anywhere in the world, and expenditure on tertiary education in Cambodia is only a small share of total Treasury-executed spending on education. Under these circumstances, increased subsidies, as currently proposed under the ESP, will disproportionately benefit Cambodia's wealthiest families. A more comprehensive and equitable strategy for public expenditure at this level is needed—such a strategy would target subsidies to poor but promising students, encourage private sector development, and invest selectively in those public institutions that meet (or are taking steps toward meeting) the new standards for accreditation.

3.64 The other major advance is the decline in repetition rates. According to MOEYS data, between 1999/00 and 2001/02, repetition rates in primary schools fell by more than half (from 22 percent to 10 percent). The decline was most significant in grades one and two where repetition rates fell from 37 to 17 percent in grade one, and from 24 percent to 10 percent in grade two. The dramatic drop in repetition is unprecedented and results in large benefits in the form of reduced public and private cost of education. It would be useful to further explore to what extent the drop in repetition is attributable to higher learning achievement as a result of the remedial program.

3.65 It is not readily apparent, however, that increased RGC expenditure on education over the past five years has improved the quality of education. The Government does not yet have a system to assess learning outcomes across the system relative to defined achievement standards. This is anticipated in the ESP so that the impact of expenditure on learning outcomes and its cost-effectiveness may be estimated.

³⁴ For 2002, the estimates assume that: (a) parents maintain the same level of per student private spending as was observed in 1997, adjusted for inflation, and (b) parents reduce their out-of-pocket expenditure on fees, books, supplies and materials by the same amount of the RGC subsidy provided through PAP for school operating budgets and textbooks.

Table 3.13: Per Student Recurrent Expenditure, Public and Private before and after PAP Subsidy

	1997				2002		
	<i>Government Per Student Expenditure (in CR)</i>	<i>Private Per Student Expenditure</i>	<i>% Private Share</i>	<i>PAP Subsidy per Student</i>	<i>Government Per Student Expenditure (in CR)</i>	<i>Private Per Student Expenditure</i>	<i>% Private Share</i>
Average							
Total	36,817	65,555	66%	13,546	89,320	61,531	41%
Primary	26,050	48,194	65%	16,043	66,024	37,954	37%
Lower Secondary	66,493	134,833	73%	3,535	145,588	147,534	50%
Upper Secondary	66,493	262,911	80%	368	145,588	294,201	67%
Post Secondary	213,396	210,454	50%	12,920	711,913	222,876	24%
Poorest 20%							
Primary		23,904	50%			10,739	14%
Lower Secondary		51,900	44%			54,614	27%
Upper Secondary		75,870	53%			84,638	37%
Post Secondary		0	0%			0	0%

3.66 An area of further challenge for MOEYS is moving toward greater gender equity in the provision of services. MOEYS proposes to pay particular attention to the causes of unequal access to educational services for girls and women and devise measures to remedy the problems (see Box 3.4)

Box 3.4: Women and Service Provision II: Barriers to Access in Education

The problem of unequal access to education services is manifested principally at the lower secondary school (LSS) level, where boys enrollments are 20 percent, and girls enrollments only 14 percent. MOEYS assessments focus on three reasons for the gender disparities in LSS.

First 39 percent of grade six students (i.e., students eligible to move onto LSS) live at least 3km, and 10 percent live at least 10 km. from the nearest LSS. Given the poor quality of rural roads, such distances present significant constraints for the majority who lack even a bicycle for transportation. Though there is a well-established system of boys living in religious institutions (temples) while attending LSS, no comparable system exists for girls. Even where LSSs are within commuting distance, parents are concerned for the safety of their daughters during the long walk to school.

Second, although direct costs of education are the same for boys and girls, parents generally perceive higher opportunity costs and lower benefits from educating daughters. Under these circumstances, poor families, who are not able to afford to educate all their children, naturally prefer to educate sons. In most families, the opportunity cost of girls' education is labor in rice fields as well as care for younger siblings and other household tasks.

Third, few schools have toilet facilities and even fewer have separate facilities for boys and girls. This situation creates obvious problems of modesty, particularly for adolescent girls.

These reasons for low girls enrollment are also found in many other countries. Household demand for girls' education has been found to be more sensitive than that for boys' distance to school in Africa, Asia and Latin America. On price sensitivity, a study using data from nearly 90 countries over three decades found that price elasticities of demand for primary and secondary enrollment are between 12 and 21 percent higher for girls than for boys. Finally, the importance of toilet facilities as a determinant of girls school enrollment has been discussed in a variety of contexts.

New and existing programs will address the first two of these concerns, though to varying extents. Construction programs to increase physical access to LSSs and scholarship programs aimed at reducing the direct cost of education to bring the total costs of education below its benefit to families are on the agenda, though total funding is uncertain. Although all newly constructed schools are expected to have toilets, there are no major efforts currently underway to provide toilets in existing school facilities.

ROAD TRANSPORT

- *Policy and Planning:* The major constraint is that sector policy goals require clarification. In addition sector goals need to be operationalized in a strategy statement and linked to the annual budget.
- *Expenditures:* Total expenditures have increased significantly, however allocations fall short of the amounts needed for maintenance and rehabilitation. If used as intended, the Fund for the Repair and Maintenance of Roads (FRMR) could, as first priority, finance routine and periodic maintenance of the currently maintainable network, plus some rehabilitation each year to restore additional segments of the network.
- *Outputs and Outcomes:* Although a start has been made on reconstruction and rehabilitation, the state of the road network remains poor, and poor road quality, which results in high transport costs, remains one of the major constraints on growth.

Sector policy and planning

3.67 **The RGC's goals for the transport sector, in the period 2001-2005 emphasize efficiency, competition and the contribution of transport services to economic growth and regional cooperation.** The Cambodian road network consists of 35,500 kilometers (km) including approximately 4,000 km of national roads and 3,500 km of provincial roads under the responsibility of the Ministry of Public Works and Transport (MPWT), and 28,000 km of tertiary roads under the responsibility of the Ministry of Rural Development (MRD).³⁵ As Cambodia is in a catch-up phase, MPWT's focus is on rehabilitating and reconstructing the main national roads, building road links to neighboring countries and developing a sustainable road maintenance program. The MRD's draft *Policy for Rural Roads* emphasizes the establishment of a strategic tertiary network linking district centers and improving access to isolated communities.

3.68 **However, as pointed out in the NPRS, while the ministries have strategies, especially for road investments, "the lack of a clear policy direction results in inadequate attention to maintenance and inefficient allocation of the transport budget (local and foreign)."**³⁶ The NPRS highlights critical issues facing the sector, including "the lack of a reliable management and financing mechanism for road maintenance, the fragmentation of public expenditures in the sector, lack of transparency, and need for clarity in the functions of ministries and institutions concerned with the management and financing of roads." The NPRS goes on to point out: "Currently investment decisions are made and contracts awarded directly by authorities other than the transport agencies. Also, transport agencies frequently receive only a fraction of their official budget allocation. This affects their ability to plan and manage the country's road assets."

3.69 **Based on this assessment, the NPRS identifies the following actions as priorities for the road sector:** (a) a reliable, steady, and adequate source of funding for road maintenance; (b) transparent management of all sectoral funds by the official transport agencies; (c) upgrading and repair of rural, provincial, and national roads; (d) competitive bidding for all government and donor-funded contracts, coupled with public outreach to the local private sector and civil society; (e) institutional strengthening and capacity building; (f) adoption of clear sector policies and strategies in support of the NPRS; (g) encouragement of public transit services using low cost

³⁵ As in many countries, the roads sector is housed in two ministries. In Cambodia MPWT is formally responsible for the overall management and development of the sector, including roads (except for rural roads), road transport, and other transport modes. MRD is responsible for rural development, including rural/tertiary roads (defined as those carrying fewer than 50 vehicles per day).

³⁶ National Poverty Reduction Strategy, 2003, p. 69.

methods' and (h) development and strengthening of regional links to facilitate the border trade with Vietnam and Thailand.

3.70 Although the NPRS action matrix incorporates many key road sector objectives, there is an urgent need to develop a consensus around a strategy that will guide and facilitate the restructuring and development of the sector.³⁷ This strategy would, among other things, lay out the principles for the planning and management of the road sector. Key principles would likely emphasize: (a) rational economic criteria as the basis for assessing road expenditure needs and determining priorities from among competing activities, projects and regions; and (b) cost recovery from user charges, at least for the primary and secondary road networks. The strategy would also establish the principles of contracting out most works and use of open and transparent tendering procedures. In this regard, both MPWT and MRD have expressed their commitment to contracting out road maintenance and rehabilitation to the private sector (see Box 3.5). However there are government-wide issues of control over and transparency of tendering decisions and procedures, especially for roads financed by the Government's own funds.

Box 3.5: Policies and Strategies for Expanding the Role of the Private Sector

The RGC's policy is to encourage greater private-sector participation (PSP) in the provision of road and road transport services and infrastructure. There is growing competition in freight and passenger transport services, although state-owned enterprises are still active in both. There also is a growing capability in the local road construction industry, fostered both by the volume of joint-venture and subcontracted work under donor-funded projects and MRD's program to strengthen the capabilities of local groups in labor-based appropriate technology (LBAT) methods of construction. These efforts at strengthening local capabilities will be given a boost by the proposed IDA-financed Provincial Rural Infrastructure Project (PRIP) and an upcoming project proposed for funding under the Japan Fund for Poverty Reduction (JFPR) in partnership with the ILO. Both projects will build on ILO activities to promote LBAT, a pro-poor initiative designed to maximize the input of local entrepreneurs, materials, labor and ingenuity in the rehabilitation and maintenance programs of both MPWT and MRD.

Opportunities for direct private investment in road infrastructure are limited, however, by political risk, security concerns, relatively low levels of traffic, the lack of an adequate legal framework for PSP that recognizes and allocates risk and responsibilities, an inadequate financial system, and a shortage of professionally-managed companies capable of handling such projects.

3.71 In the absence of a coherent sector plan, it is impossible to assess total requirements and arrive at a prioritised, balanced program of maintenance and rehabilitation of the road network. At present there is no systematic, unified planning and budgeting process. The analytical tools (e.g., pavement management systems) are in the process of being established in the sector ministries with the help of donors, but to date have provided little input to the planning and budgeting process. The lack of a coherent plan and budget are partly explained by two factors: (a) the country has been in a period of emergency reconstruction and is only now establishing systems and procedures; and (b) approved programs and budgets have not governed actual expenditures. Many decisions are made without the knowledge of the sector ministries responsible for roads, and there is a lack of transparency in investment and procurement decisions.

³⁷ A draft policy statement was prepared as part of the recently completed Transport Sector Study (TSS), June 2002. The policy is in its fourth revision, but still under consideration.

Table 3.14: Road Transport Sector – NPRS Action Plan Matrix

<i>Objectives</i>
1. Improve accessibility of road networks, and ensure cost-effective and safe transportation 2. Ensure that transport policy supports poverty reduction objectives. 3. Improve rural transport through maintaining existing road assets and enhancing rural access and mobility
<i>Strategies</i>
Improved Access 1. Restructure intercity public transport to enable better, more cost-effective and safer service 2. Reconstruct roads aligned with international standards 3. Rehabilitate roads for connection between South East and North West regions 4. Maintain roads for a sustainable and efficient road network 5. Review road code, including road safety initiatives for preparing a national road safety plan Support of Poverty Reduction 1. Formulate (in a participatory manner), adopt, and implement a national transport policy, including rural and urban transport, and a strategy for private sector participation Improved rural transport 1. Prepare rural roads inventories and mapping 2. Sustain and improve living standard of people by maintaining existing rural roads using Labor-Based Appropriate Technology (LBAT) 3. Maintain and rehabilitate rural transport infrastructure using LBAT to increase rural access and generate rural employment in a sustainable and environmentally friendly way 4. Review availability, affordability, and safety of rural transport services
<i>Outputs</i>
Improved Access ➤ 50 km/year of road constructed ➤ 500 km/year of roads rehabilitated ➤ 2,000 km/year of road maintained Support of Poverty Reduction ➤ Policy and strategy formulated in 2003-2004 and adopted in 2005 Improved Rural Transport ➤ 60 percent of total (31,000 km) road length mapped by 2005 ➤ 4,500 km of rural roads maintained in good condition by 2005 ➤ 3,000 km of tertiary and sub-tertiary roads improved by 2005 and 5.7 million working days of employment generated (45 percent female) ➤ Road accidents in rural areas reduced by 25 percent by 2005

Road transport sector expenditures

3.72 Total expenditure on roads has increased significantly in the past several years, and are likely to increase further as resources become available from the Fund for the Repair and Maintenance of Roads (FRMR) (See Box 3.6). There has been dramatic growth in capital expenditures for MPWT, which have increased by a factor of three (in nominal terms) from 1998-2001, and MRD, which saw a tenfold increase from 1997-2002 (in nominal terms) and much more if PAP allocations from the current budget are included as shown in Table 3.15. This resource shift reflects the high priority given to road rehabilitation in recent years (though not all MPWT and MRD expenditures are for roads).³⁸ It is estimated that total annual Treasury-

³⁸ Consolidated information on planned and actual expenditures on roads is unavailable, as road spending is not separately itemized in the budget and accounts prepared by MEF, MPWT and MRD, nor is it reported for the FRMR. It is assumed, based on discussions with Government officials, that 80 percent of MPWT's current expenditure and 90 percent of its capital expenditure, and 70 percent of MRD's current expenditure and 90 percent of its capital expenditure, are for road-related activities.

executed expenditure (that is, excluding external project-related assistance) on road rehabilitation and maintenance (excluding expenditures funded from the FRMR) was on the order of CR 106 million in 2001, equivalent to about US\$ 28 million. Of this some US\$ 21 million (76 percent) was for MPWT's national and provincial network³⁹ and US\$ 7 million (24 percent) for MRD's tertiary network. Capital expenditures made up about 77 percent of the total (78 percent if MRD's PAP expenditures, used almost entirely for road rehabilitation and repair, are included). Table 3.16 summarizes these estimates of road expenditure in 2001 (assuming that expenditures from the road fund were at the same rate as for 2002). External assistance for the transport sector is estimated at US\$ 59.7 million in 2001.

Box 3.6: The Fund for the Repair and Maintenance of Roads (FRMR)

The FRMR was established in June 2000 (Prakas #399) to provide funding for road repair and maintenance. Initially financed from loans from MPWT-owned enterprises, the fund has been supplemented since January 2002 by a surcharge of US 2 cents per liter on gasoline and US 4 cents per liter on diesel, levied by the Customs Department at the point of import. In May 2002, with the accumulated revenue reportedly amounting to an estimated US\$ 3.5 million, the management of the FRMR was transferred to MEF, under the direct control of the OPM (Sub-decree #39). Target levels of revenue have been estimated by MEF at US\$ 10 million to US\$ 25 million annually—though TOFE reports indicate that revenues totalling about \$26 million had been earmarked to the fund in 2002.

So far, most of the funds have been used for road rehabilitation projects (as well as a few rehabilitation projects in other sectors such as water resources), in much the same way as the MEF's capital budget. Rather than provide a predictable basis for maintenance planning and the development of maintenance systems, funds are allocated by the OPM to projects proposed by provincial administrations or directly by the MCE, without reference to transparent criteria and processes for determining priorities. Since technical oversight agencies are not routinely involved in the financing decision or in monitoring implementation, there is little scope to monitor performance to ensure value-for-money.

If the FRMR is to achieve its objectives in providing adequate, predictable funding for road maintenance, its institutional framework will have to be strengthened to clarify its function and oversight structure. Important first steps could include: (a) creation of oversight arrangements that would monitor the use of funds to be used for roads (such as technical and financial audits); and (b) adoption of a formula-based allocation mechanism that would allocate resources to institutions and provinces for road maintenance on the basis of the length of road maintenance network to be maintained, allowing them to program maintenance activities well in advance and develop the necessary maintenance systems. In many countries, oversight arrangements include the creation of a management board, comprising private and public sector representatives, responsible for applying allocation criteria and contracting out the audit and inspection of road maintenance works.

Table 3.15: Total Current and Capital Expenditures, MPWT and MRD, 1997-2001
(CR millions)

Ministry	Expenditure	1997A	1998A	1999A	2000A	2001B	2001A	2002B
MPWT	Current	6,944	6,373	9,322	20,316	23,050	21,456	22,940
	Capital	17,190	6680	19,926	52,267	0	70,682	0
	Total	24,134	13,053	29,248	72,583	23,050	92,138	22,940
MRD	Current a/	2,037	2,215	3,256	7,558	13,730	12,513	20,000
	Capital	1,649	3,783	12,474	4,810	0	18,163	0
	Total	3,666	5,998	15,730	12,368	13,730	30,676	20,000
Grand total		27,820	19,051	44,978	84,951	36,780	122,814	42,940
Pct. of Govt. Expenditure		22%	12%	25%	4.1%	1.5%	5.1%	1.6%

a/ Includes PAP. A=actual; B=budgeted. Source: TOFE and annual budgets.

³⁹ The August Memorandum of Understanding (MOU) in preparation for the Asian Development Bank supported *GMS: Cambodia Road Improvement Project* puts the figure for primary and secondary roads much higher at US\$ 79 million per year, with the Government providing about 20 percent and development partners the rest. This significant discrepancy needs clarification by MEF, MPWT and MRD.

3.73 During the reconstruction period, approximately 1,500 km of national roads under MPWT and approximately 11,000 km of rural roads under MRD have been rehabilitated. This has been achieved by donor funded support, government own funded works and includes approximately 900 km implemented by the Military Corps of Engineers (MCE).

Table 3.16: Estimated Expenditures on Roads Only, MPWT and MRD, 2001

Ministry	Expenditure	CR millions	US\$ millions
MPWT	Current	17,000	5
	Capital	64,000	17
	Total	81,000	21
MRD	Current ^{a/}	9,000	2
	Capital	16,000	4
	Total	25,000	7
MEF/FRMR	Capital	70,000	18 ^{b/}
Grand Total		176,000	46

^{a/} Includes PAP.

^{b/} MEF/FRMR includes approximately US\$ 3.5 million from the FRMR and the remainder from MEF allocated funds.

Source: World Bank estimates based on discussions with officials, TOFE, and annual budgets.

3.74 Both MPWT and MRD have ambitious plans to rehabilitate their respective networks. For MPWT's national and provincial road network, projections of annual road rehabilitation and maintenance expenditures rise to a high of US\$ 176 million as the rehabilitation effort scales up before falling to a long-term sustainable level (see Figure 3.9).^{40,41} To put the cost of rehabilitation in context, if MPWT rehabilitates a further 2,500 km of its national network at an average cost of US\$ 100,000 per km, the cost will rise to about US\$ 250 million over a five year period (about US\$ 50 million per year), and increase the routine maintenance responsibility for the resulting 4,000 km national network to US\$2–4 million per year. For MRD's tertiary road network over the 2001-2005 period, MRD envisages the rehabilitation and maintenance of an ambitious 21,195 km at an estimated cost of US\$ 57 million. This estimate of needed expenditure is understood to reflect economical standards appropriate to tertiary roads, however there has been no comprehensive survey of road conditions nor economic evaluation of the proposed expenditures. While issues of funding and maintenance management are beginning to be addressed for the primary and secondary network, they have received little attention as yet for the more extensive tertiary network.

3.75 A comparison of the projected costs of rehabilitating and maintaining the entire road network with current resource availability reveals a shortcoming of enormous magnitude. Assuming an average cost of US\$ 11 million per year to rehabilitate and sustain the tertiary network, and expenditures on the order of US\$ 120-130 million per year for the primary and secondary network, Government resources are able to cover less than one third of the total annual cost. External financing, though it will help close the gap, looks to be insufficient, at least over the medium term, to meet expenditure needs.

3.76 A principal concern is the lack of expenditures for road maintenance. Almost all rehabilitation works and periodic maintenance on the national and provincial network are carried out on a project basis, whether local or donor-funded. Routine maintenance, to the limited degree it is carried out, and some small-scale emergency repairs, are funded from the recurrent budget. For the tertiary network, most road works—usually regaveling of strategic roads or emergency maintenance—are carried out using PAP funds or as projects under the capital budget.

⁴⁰ Estimated at less than US\$ 40 million per year once failed sections are repaired and road conditions can be held stable through a normal program of periodic and routine maintenance.

⁴¹ Based on the 2001 surveys by ADB TA 3257-CAM.

3.77 The challenge is to improve public expenditure management so that funds are both released and used for routine and periodic maintenance, in order of priority. The problem of inadequate maintenance expenditure will become more important as the size of the maintainable network increases. For MPWT, the 1,500 km of national roads already rehabilitated require at a minimum US\$ 500 to US\$ 1,000 per km per year in routine maintenance. For MRD, the 11,000 km of tertiary roads already rehabilitated require at minimum US\$ 300 to US\$ 500 per km per year in routine maintenance expenditures. Table 3.17 indicates that the increasing the size of the maintainable network will have significant impacts on annual maintenance costs.

Table 3.17: Annual Routine Maintenance Cost (US\$) on Different Network Size Options

	Size of network (km)	US\$ ^{a/}
MPWT	1,500	1,125,000
	4,000	3,000,000
	7,500	5,625,000
MRD	11,000	5,500,000
	28,000	14,000,000
Total	35,500	17,750,000

^{a/} Estimated unit costs are US\$ 750/km for MPWT and US\$ 500/km for MRD.

Source: World Bank staff estimates.

3.78 Given the likelihood of resource scarcity for the foreseeable future, it is even more important that sector expenditures are managed efficiently and effectively.⁴² However, sector expenditure management presents serious concerns in this regard. For example, for the primary and secondary network, most rehabilitation works carried out under the national budget, as opposed to donor projects, are not subjected to a transparent process of planning based on objective surveys and rational criteria. Decisions about the allocation of funds from MPWT's capital budget (with the exception of counterpart funds for donor projects) are made by MEF and from the FRMR by the OPM, though it is not clear to what extent decisions are based on the same technical or economic criteria that are applied to other, donor-funded, rehabilitation programs.

3.79 Detailed expenditure data from the FRMR are not available. These problems are compounded by the lack of a competitive bidding process for large capital projects.⁴³ Addressing these shortcomings is critical for improving the efficiency and effectiveness of expenditures in this important sector.

Road transport sector outputs and outcomes

3.80 Roads are fundamental to economic growth and social development. Almost all of Cambodia's border trade with Thailand⁴⁴, Lao PDR and Vietnam (as well as traffic through the international port of Sihanoukville) moves by road. Without an arterial network in good condition, the costs of transporting the country's international and domestic trade and passenger traffic are high relative to neighboring countries, negatively affecting incomes, prices and welfare throughout the economy. Improved access is a cornerstone of the Government's NPRS: it helps

⁴² International experience suggests four elements are key to putting the management and financing of roads on a sound basis: (1) creation of "ownership" by involving road users in the management of roads; (2) stabilization of road financing by securing an adequate and stable flow of funds; (3) clarification of responsibilities so that there is no ambiguity regarding responsibilities; and (4) strengthening managerial accountability.

⁴³ Government frequently engages in pre-financing arrangements with contractors, thus building up arrears to suppliers (flows of arrears, though not stocks, are reported in the TOFE).

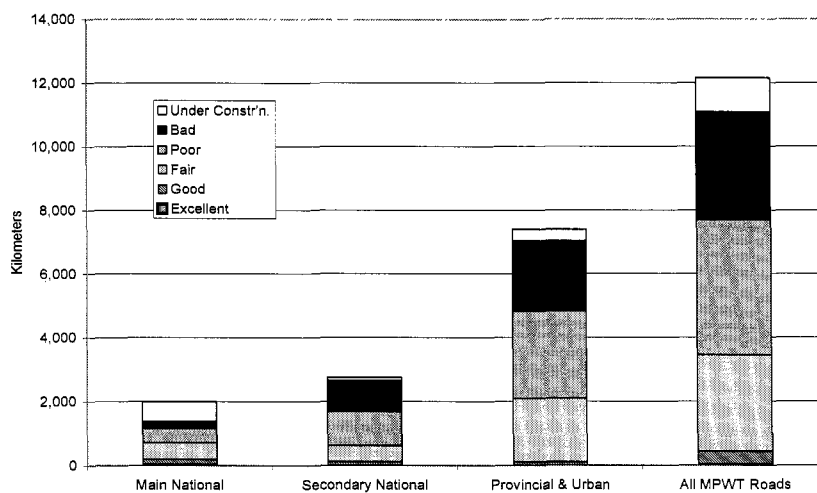
⁴⁴ Recorded trade across the Poipet-Aranyaphathet border amounted to US\$ 238 million in 1999, up from US\$ 27 million in 1992, partly due to a rerouting of trade following the upgrading of NR5 and restoration of peace in the area. Some 56,000 tourists crossed the border in 2000.

reduce the costs of farm inputs, increase prices available to farmers, and open up non-farm income-earning opportunities.⁴⁵

3.81 Three decades of civil war, political instability, and neglect had brought Cambodia's road infrastructure to the point in the mid-1990s where sections of even major national routes were impassable in the wet season.⁴⁶ With donor assistance, a start has been made on the reconstruction, rehabilitation, and institutional strengthening needed to bring the network to the condition where it can be maintained on a sustainable basis. Since then, about a third of the total length of primary and secondary roads and 11,000 km of tertiary roads have been improved.

3.82 In 2002, road condition surveys confirmed that 28 percent of the network is in good and fair condition, 35 percent in poor condition, 28 percent in bad condition and 6 percent under reconstruction or rehabilitation. The main national roads are in better shape than the rest: 40.7 percent was in good or better condition in 2001, compared with 7.7 percent for secondary national roads and 6.5 percent for provincial and urban roads (Figure 3.8).⁴⁷ Unfortunately, information is not available with which to reconcile this evidence of road conditions with information on the lengths of road recently rehabilitated or to reach conclusions about the effectiveness of maintenance of road sections once upgraded.

Figure 3.8: Condition of the MPWT Network, 2001



Source: MPWT/ADB, 2002.

3.83 There has been no survey of MRD's tertiary network, but up to 11,000 km of rehabilitation work (mostly regravelling) is reported to have been carried out by MRD in recent years. Much of the rest is acknowledged to be in bad condition.

3.84 The impact of the poor state of the road network is felt in high transport costs, which impede economic growth and service delivery, and in citizen safety. Road traffic levels are low, suppressed by poor road conditions, security concerns, and a vehicle fleet that is

⁴⁵ The results of a survey of the impacts of local road improvements in Siem Reap are given in Jan Sakko, *Access, Transport and Local Economic Development*, ILO ASIST, 1999.

⁴⁶ Vehicle operating costs (VOCs) on badly-deteriorated roads are some 25-50 percent higher than on well-maintained roads due to higher rates of vehicle wear-and-tear, increased fuel consumption, and lower vehicle productivity. See, for example, *Road Deterioration in Developing Countries*, World Bank Policy Study, June 1988.

⁴⁷ The surveys were carried out under ADB TA 3257-CAM: *Strengthening the Maintenance Planning and Management Capabilities at the Ministry of Public Works and Transport*. They covered the more important links, amounting to 27 percent of the total length. The condition of remaining national, provincial and urban roads was inferred from other data, discussions with MPWT and provincial officials, and informed judgment.

expanding fast but from a low base. Nonetheless, traffic has grown more rapidly as some of these constraints have been addressed. Between 1991 and 2000, the registered four-wheel fleet grew at an average of 24 percent per year and motorcycles by 15 percent.

3.85 Compared with its Thai and Vietnamese neighbors, Cambodia's road transport industry is embryonic and inefficient. Most goods are carried on old, overloaded trucks with low levels of utilization. In more isolated regions, goods are transported mainly by motorcycle and animal-drawn vehicles.

3.86 Even without allowing for under-reporting, Cambodia has one of the highest traffic fatality rates in Asia: 12.1 deaths per 10,000 vehicles.⁴⁸ The main reported causes are driving under the influence of alcohol, poor adherence to traffic regulations, and unqualified (i.e., unlicensed) drivers. Existing record-keeping is not able to distinguish among other factors that probably also affect road safety: poor road designs, low safety awareness among drivers and pedestrians, unsafe vehicles and speeding. Motorcycles are implicated in a high proportion of both fatalities and all accidents; they are widely used for public transport and often constitute the largest share of traffic, particularly in or near settled areas.

3.87 Although rehabilitation efforts have resulted in some immediate improvements in road conditions and institutional performance, there remain doubts about their effectiveness and sustainability over the longer term. Improving the targeting of sector expenditures to sector priorities, and ensuring that expenditures have high economic and financial returns, will be necessary for making roads instruments of national development.

AGRICULTURE ⁴⁹

- *Policy and Planning:* Though the NPRS makes progress in sector planning, the agriculture sector still lacks a coherent pro-poor policy framework linked to the budget.
- *Expenditures:* The sector is under-funded. In economic terms the shift from wage spending to research (mostly transfers to other institutions) has reduced allocative efficiency. Moreover, sector spending is not targeted to pro-poor programs and regional departments are resource-deprived.
- *Outputs and Outcomes:* Low levels of funding and the inefficiency of spending constrain both broad-based economic growth and poverty reduction. Sector outputs in the form of direct service provision to clients are limited. A lack of effective sector monitoring makes evaluation of impact difficult.

Sector policy and planning

3.88 Rural issues, particularly improvements in smallholder family farms' productivity and market access, feature prominently in the SEDP II and the NPRS. The NPRS sets out the following sectoral priority objectives: (a) establishing the appropriate legal and institutional framework, (b) improving MAFF's capacity, (c) increasing the knowledge and skills of farmers, (d) promoting intensification and diversification, and ensuring the security of agricultural productivity, (e) promoting sustainable natural resource management and conservation, (f) strengthening market access, (g) developing and implementing an irrigation and drainage (ID) information system, (h) strengthening capacity in project formulation and implementation of

⁴⁸ Comparable rates (2000) are: Vietnam 10.8, Malaysia 5.7, Thailand 5.6, and Singapore 2.9. Developed countries have rates in the range 1.5-1.9. Source: First GRSP ASEAN Seminar, March 2001.

⁴⁹ This section does not cover land issues.

sustainable ID projects using a participatory approach, and, among others, (i) facilitation and promotion of small-scale, private investment in ID.⁵⁰

3.89 Unfortunately, however, the sector still lacks a coherent, pro-poor policy framework. This results in unprioritized objectives (the 2002 MAFF annual report provides a long list of over 40 objectives, which do not seem to be prioritised, for 2003) and fragmented spending.⁵¹ Part of the problem is the overlapping jurisdiction of sectoral ministries and the lack of coordination between them, both of which are consequences of the weak administrative capacity that characterizes the rural sector. Without a clear set of prioritised objectives, it is difficult to analyse sector spending. Moreover, given the weak policy framework, sector expenditures become a function of historical spending patterns and *ad hoc* initiatives, which means that there is no mechanism for focusing expenditures on pro-poor policies. The lack of an established monitoring and evaluation system means that the results of sector spending cannot be systematically analysed. It is urgent that the Government re-evaluate the role of the sector by developing a coherent pro-poor policy framework that: (a) prioritizes sector goals and objectives, and develops a strategy to reach them; (b) examines the role for public sector intervention in agriculture vis-à-vis the private sector, and (c) rationalizes the administrative structure of the sector.

Rural sector expenditures⁵²

3.90 The rural sector is under-funded in terms of the size of its national budget allocation relative to its economic importance and its potential for poverty reduction. Though RGC funding for the sector (MAFF and MOWRAM) has increased from 1.35 percent in 1999 to 1.8 percent in 2002 as a share of the Government's budget (from CR 27.5 billion to 50.0 billion in nominal terms), the size of the allocation is low in view of the relatively large share of the population, workforce, and the poor who are dependent on agricultural activities for income generation and food security. In per capita terms, current spending was merely US\$ 0.93. Unfortunately, however, even given the importance of the agricultural sector for income generating activities and poverty reduction, it would be unwise to increase sectoral allocations until an agreed, coherent sector policy framework is in place. Given such low overall sector spending, the problem is not so much one of an imbalance in spending; both operations and maintenance as well as personnel expenditures need to be increased. At the same time, the RGC should look to improvements in efficiency to help fund increased expenditures. A functional review of the sector (MAFF, MRD, MOWRAM, MLMUPC, etc.) should provide guidance on reducing administrative overlap and fragmentation, thereby releasing resources for more productive use (see Chapter 5).⁵³

3.91 In economic terms there has been a significant shift in composition away from remuneration and toward economic interventions in both MAFF and MOWRAM. Remuneration as a percentage of recurrent expenditures has declined from 29 percent in 1999 to 17 percent in 2002 according to budget data (for total sectoral spending). Expenditures for operations and maintenance (Chapter 11) have also declined from 57 percent to 48 percent,

⁵⁰ NPRS Action Plan Matrix, pp. 172-185.

⁵¹ "Report on the Situation of Agriculture, Forestry, and Fisheries in 2002," MAFF, January 2003 (unofficial translation).

⁵² The following covers resources available through MAFF (Ministry of Agriculture, Forestry and Fisheries) and MOWRAM (Ministry of Water Resources and Meteorology) to support the development of agriculture, forestry, and fisheries, including the provision of water to the agricultural sector.

⁵³ MAFF itself cites "overlap" between responsible institutions and departments, "lack of coordination," and "unclear organization structure" as major constraints in the sector. See "Annual Conference on Agriculture, Forestry and Fisheries" (April 10-11, 2002), MAFF, p. 15.

though PAP funding, which totalled 12 percent of total recurrent spending in 2002, compensates for the decline in Chapter 11 resources.

3.92 PAP, which was intended to bring greater alignment to sector policy and spending, does not seem to have had the intended impact. PAP resources do not seem to be directed to high priority services as intended. For example, PAP expenditures on forestry replanting accounted for 28 percent of total PAP spending in 2001 and 54 percent in 2002. Of these funds, MAFF reports that the majority were spent on remuneration for staff and wages for contract workers (once again indicating the use of PAP by line ministries to by-pass low civil service pay scales). PAP funds were also spent on animal health, community fisheries, and agricultural research (the Cambodian Agriculture Research and Development Institute, CARDI, and the Royal University of Agriculture, RUA), as well as the Institute of Rubber Research (IRR) and animal food for the state zoo.

3.93 It is also unclear whether the increase in economic interventions (Chapter 30), which more than doubled as a share of total recurrent spending from 1999 to 2002, is pro-poor. In absolute terms economic interventions increased from CR 1,000 million in 1999 to CR 4,427 million in 2002, 87 percent of which was allocated to CARDI, the RUA, the IRR in 2002 (the remaining 13 percent was allocated to rice seed subsidies). It is not apparent why the sudden four-fold increase in spending on these items became a priority in 2001. Total Chapters 13 and 30 spending on research is thus very high as a proportion of MAFF's total recurrent budget. Given these high relative and absolute levels of expenditure, MAFF should undertake a cost-effectiveness analysis to ensure that spending is productive and consistent with sectoral priorities.

3.94 Overall, the level of capital spending in the sector is low, with MEF reporting no capital spending for MAFF between 1999 and 2001. Capital spending, both RGC-financed and donor-financed, is difficult to estimate for this sector and there are discrepancies in data reported from different sources. MOWRAM, however, shows a surge in Government-financed capital spending from CR 236 million in 1999 to CR 3.83 billion in 2000. The rapid rise in spending at MOWRAM raises concerns not only about administrative capacity in the newly-formed ministry, but also about the proper allocation of operating and maintenance expenditures to cover the capital base.

3.95 An examination of spending by program in MAFF also raises concerns about the focus on poverty-reducing priorities. Table 3.18 shows spending by service department/program. Forestry accounts for fully 21 percent of total recurrent spending and nearly half of total direct service spending. In comparison, agricultural extension accounts for less than one percent of total recurrent spending.⁵⁴ Animal health and agronomy also account for relatively low shares. Taking account of the priorities identified in the NPRS would seem to indicate a fairly radical reorientation of expenditures at the sub-sectoral level.

3.96 Furthermore, an analysis of the regional spending pattern shows that the provinces only receive about 39 percent of total MAFF and MOWRAM spending, while the central level consumes the remaining 61 percent. The share of O&M expenditures in total recurrent spending made by the central ministries has remained fairly constant at about 40 percent (including Chapters 11 and 13) while the share at the provincial level has increased slightly from 17 percent in 1999 to 20 percent in 2002. Still, given the nature of the mandates of these ministries, it would seem that spending is too concentrated at the central level, with potentially negative impacts on front-line service delivery.

⁵⁴ This does not include external assistance, a large share of which is reportedly directed to extension. Due to the lack of data, however, it is not possible to analyze the total amount of spending on extension services (see Chapter 4).

Table 3.18: MAFF Budget Allocations by Department/Program (Share of Total Recurrent), 2002

Department/Program	Share
Forestry	21.1%
Fisheries	11.2%
Agronomy	6.3%
Animal Health	4.8%
Agricultural Extension	0.8%
Machinery	2.0%
Agro-Industry	0.7%
<i>Sub-total</i>	<i>46.9%</i>
Rubber	6.6%
Educational and Research	22.2%
<i>Sub-total</i>	<i>28.8%</i>
Central ministry	23.3%
Total	100.0%

Note: Does not include external assistance.

Source: MAFF.

3.97 Concerns about the efficiency of sectoral resource allocation are not limited to MAFF and MOWRAM alone. Cambodia's rubber companies, which are divested public enterprises under the jurisdiction of MAFF's General Directorate of Rubber Plantations, are not profitable, and appear to drain some limited resources from the sector. In 2001, for example, total profits from the seven rubber enterprises amounted to CR 700 million on a capital stock valued at approximately CR 420,000 million, which indicates a rate of return of about 0.2 percent. Some companies, such as Chamkar Andaung, have been posting losses for years. Though MAFF does not report regular subsidies to these enterprises, it does provide funding on an "emergency" basis. It is not clear how companies' operating deficits are funded. Rationalization of management of these companies, and a redirection of resources away from them, would improve efficiency.

Sector outputs and outcomes

3.98 The performance of the agriculture sector is central to the provision of income generating activities, the reduction of poverty, and to increased food security for the majority of the population. More than 70 percent of Cambodia's population are employed in agricultural production and most are smallholders with less than 2 hectares per household.⁵⁵ Women make up the majority of farmers (1.4 million compared to 1.2 million men). The overwhelming majority of the poor (79 percent) are employed in the agriculture sector, and the highest poverty rates are found among households headed by farmers and households with little or no formal education.⁵⁶

3.99 In spite of its growth and poverty-related potential, sector performance is hampered by numerous constraints. For example, a recent study points to a number of key constraints in the rice sector, in which the majority of Cambodian farmers operate: (a) low agricultural productivity, (b) high credit costs for farmers and millers, and (c) the need for improvements in seed varieties, access to inputs, and agricultural extension.⁵⁷ The Government's sector strategy would need to address these constraints, as well as those specific to other key agricultural sectors, in order to provide the underpinnings for more efficient and effective sector expenditure.

⁵⁵ Cambodia SES, 1999.

⁵⁶ Poverty mapping results from WFP and "Estimation of Poverty Rates at Commune Level in Cambodia" (RGC, October 2002).

⁵⁷ "Rice Value Chain Study: Cambodia," Agrifood Consulting International (for the World Bank), September 2002.

Box 3.7: Women and Service Provision III: Barriers to Access in Agriculture

Although women make up the majority of farmers, they are a minority among beneficiaries of public services, accounting for only about 20-30 percent of participants in extension programs. The direct causes for low service delivery to and utilization by women are numerous:

- Agricultural research and extension do not focus on the activities of female farmers, which is a problem given that men and women specialize in different tasks.
- Access to extension services often requires traveling to the district center which is an average of 9 km from the village. Safety concerns make women hesitant to travel. Moreover, their responsibilities for cooking and caring for children make it difficult for women to be gone for more than a few hours at a time.
- The overwhelmingly male extension service staff find it socially difficult to engage in face-to-face communication with female farmers. Men are offered training and extension activities even when their wives are the ones carrying out the tasks being studied. Experience in Cambodia as in other countries shows that this knowledge is rarely passed on effectively from husband to wife. Female extension agents tend to have easier time communicating messages to female farmers, but it is estimated that only about 5 percent of agricultural extension agents are female.

3.100 Moreover, the importance of the sector is not matched by either its resource allocation or administrative capacity. Nor is reliable, consistent data on sector outputs and outcomes available. MAFF does maintain economic statistics on the sector, including data on crop, livestock, and fisheries production, for example, which are produced annually. It has very limited data on sector service delivery. The only information available from MAFF pertains to the number of vaccines provided and the number of participants in extension training programs (this data was available in 2002, but not in 2001, in the annual conference materials). The data that are available reveal the limited scope of MAFF's provision of direct services to clients. As would be expected given budget allocations, the number of participants attending some form of extension training was very limited (given 2.6 million farmers, and fewer than 20,000 MAFF extension program participants in 2002, it would take 65 years to reach half of Cambodia's farmers). Establishing a program to monitor MAFF outputs linked to key sectoral outcomes and sector planning instruments is necessary for improving resource targeting.

CONCLUSION

3.101 There is thus considerable scope for improving the impact of spending by improving the key linkages in the *policy—expenditure—output—outcome* production process. Table 3.19 summarizes the findings. Sector policy development, especially in transport and agriculture, and its link to the NPRS, will necessarily become a priority. The efficiency of spending in economic, geographic, and programmatic terms, will need to be improved if poverty is to be reduced further. Indeed, given competing demands for resources over the medium term, it will be essential for the Government to improve the efficiency and effectiveness of spending in both the social and economic sectors. Improving the accountability of Government to citizens is a critical avenue for improving the impact of public spending.

3.102 The analysis suggests two overarching measures for improving the efficiency and effectiveness of expenditures. First, the priority focus of spending should be sharpened by improved targeting to the poor. Second, the institutional mechanisms that mediate between resources and services need strengthening. Many of the problems and their consequences discussed in this chapter are both systemic and institutional in nature—they affect the entire public sector and cannot be resolved at the level of individual sectors. Thus, these first three chapters on resource generation, allocation, and policy would be incomplete without an analysis of the institutional underpinnings of service delivery. In order to improve service delivery, the

Government must improve *the institutions that translate expenditures into outputs*—the public expenditure and financial management system (Chapter 4), the civil service (Chapter 5), and decentralized governance (Chapter 6)—each of which are taken up in turn.

Table 3.19: Linkages between Sector Policy, Expenditure, and Outputs/Outcomes

	Policy and Planning	Expenditure	Output/Outcome
Health	➤ The health sector has made important progress by basing its strategy on monitoring outputs and outcomes. ➤ Further work is necessary to cost and operationalize the strategy by linking it effectively to the budget.	➤ The allocative efficiency of spending could be increased (the wage share is too low and maintenance spending is inadequate). ➤ The share of spending at the provincial level is too low and the high inter-provincial variance results in inequalities in per capita spending across the country. ➤ The result is inadequate targeting of resources, which reduces the pro-poor impact of spending.	➤ There have been some significant achievements in the sector, especially regarding communicable diseases and expanded coverage of the population. ➤ However, serious problems need to be addressed, including low and uneven access to services and the inadequate pro-poor incidence of spending ➤ Service quality continues to be a concern.
Education	➤ The sector planning process is well-developed and effectively linked to the budget and nascent MTEF.	➤ There has been a significant increase in Government funding over the past few years. ➤ The major share of spending is allocated to primary education. ➤ The wage share of recurrent spending has dropped to unsustainably low levels.	➤ Steady progress has been made since 1999, in expanding educational opportunities with total enrolment growing. ➤ Enrolment growth has been concentrated among the poor. Repetition rates have also fallen. ➤ The focus on primary education means that sector spending has become increasingly pro-poor. ➤ However, net enrolment ratios and the completion rate at the primary level are the lowest in the region. ➤ Service quality continues to be a concern.
Road Transport	➤ Sector policy goals require clarification. ➤ Sector goals are not operationalized in a strategy statement, nor are they linked to the annual budget.	➤ Total expenditures have increased significantly, however allocations fall short of the amounts needed to bring the network up to a maintainable state. ➤ Routine and periodic maintenance are not funded on an on-going basis. ➤ The FRMR could, as first priority, finance routine and periodic maintenance of the currently maintainable network, plus some rehabilitation.	➤ Although a start has been made on reconstruction and rehabilitation, the state of the road network remains poor, and poor road quality, which results in high transport costs, is one of the major constraints on growth.
Agriculture	➤ Though the NPRS makes progress in sector planning, the sector still lacks a coherent pro-poor policy framework linked to the budget.	➤ The sector is under-funded. ➤ The shift from wage spending to research has reduced allocative efficiency. ➤ Sector spending is not targeted to pro-poor programs and regional departments are resource-deprived.	➤ Low levels of funding and the inefficiency of spending constrain both broad-based economic growth and poverty reduction. ➤ A lack of sector monitoring makes evaluation of impact difficult.

4. REFORMING INSTITUTIONS TO IMPROVE SERVICE DELIVERY I: THE PUBLIC EXPENDITURE AND FINANCIAL MANAGEMENT SYSTEM

“A critical aspect of NPRS preparation and implementation lies in the link to the budget. Budget allocations need to be consistent with the NPRS and, just as importantly, the execution and management of the budget must follow as intended.”⁵⁸

THE REFORM AGENDA

4.1 The Royal Government of Cambodia (RGC) has placed public expenditure and financial management (PEFM) reform squarely on its development and poverty reduction agendas.⁵⁹ Recent initiatives have built on a previous round of reforms, launched after the promulgation of the Organic Budget Law in 1993, which established the institutional architecture for budgeting, planning and budget execution. Priority was given to the development of systems that guaranteed budgetary discipline, through a process of commitment control and centralized payments system. These reforms achieved their objective in delivering—with the exception of a period of fiscal instability following the disturbances of 1998—budgetary restraint, reflected in current balances of over 1.2 percent of GDP in each the last four years. They have also been instrumental in increasing expenditures on the priority sectors of education and health, while reducing spending on defense and security.

4.2 It has become increasingly apparent, however, that weaknesses in the public expenditure and financial management system (PEFM) not only have high costs in terms of allocative and operational efficiency but also create unacceptably high levels of fiduciary risk to public funds. The cash-based payments system has emerged as a major constraint. Increasingly, budget execution has suffered from delays and an unpredictable release of funds, due to cash constraints, undermining operational planning, and leading to the build-up of arrears. The system is plagued by gate-keeping and deficient accounting and reporting systems, thus leading to a weak control environment and increasing opportunities for corruption. Indeed, in comparative perspective, Cambodia’s PEFM system ranks below average (as compared to the low income countries assessed by a joint World Bank-IMF diagnostic tool), indicating that Cambodia’s system requires substantial upgrading (see Box 4.1).

4.3 Attempts have been made to address these problems by implementing pilot initiatives, notably the Accelerated District Development and Priority Action Programs (as recommended by the 1999 PER), together with a “sector wide” approach in aid coordination, first in education and health. This has improved the alignment of resources with policy objectives and helped channel funds to operational units, but their impact has been muted by liquidity constraints and concerns over the adequacy of control arrangements. Within MEF, attention has recently turned to the improvement of treasury operations, cash management, and public accounting so as to address these concerns. At the same time, MEF has made progress in the development of a

⁵⁸ “Cambodia: National Poverty Reduction Strategy,” December 2002, p. 127.

⁵⁹ This chapter is based in part on the Cambodia CFAA (see Annex C).

medium term expenditure framework, which, it is hoped, will improve resource allocation and the predictability of resources over the medium term.

Box 4.1: Cambodia's PEFM System in Comparative Perspective

The World Bank and IMF recently developed a diagnostic tool to assess the quality of public expenditure and financial management (PEFM) systems in the context of the Highly Indebted Poor Country (HIPC) debt relief initiative. One of the objectives of the tool is to "assess the existing capacity for tracking overall public spending, including poverty-reducing spending." The tool assesses PEFM systems according to fifteen criteria that focus on budget formulation, execution, and reporting. The assessment tool also provides an indicative benchmark for each question. The benchmark is not necessarily the ideal, but rather the standard that low income developing countries committed to comprehensive reform should be able to meet.

The joint Board paper found that for the twenty-four countries assessed, the mode number of benchmarks met was eight, and the mean was six. Nine of the twenty-four HIPCs were deemed to require "some upgrading" as they met more than half but less than two-thirds of the benchmarks. The remaining fifteen HIPCs were deemed to require "substantial upgrading," as they met less than half the benchmarks. These assessments were agreed to by the country authorities. A Bank assessment of Cambodia's PEFM system as part of the IFAPER found that Cambodia met only three of the benchmarks, putting it on par with Niger and Zambia.

What the assessment reveals is that compared with its low income country peers, Cambodia's PEFM system is below average, in spite of reform initiatives undertaken in the context of Bank-Fund programs and with other donors' support. While cross-country tools such as these cannot provide perfect comparability, and while they only provide for comparison with a subset of countries, they are useful for indicating where countries stand relative to a reasonable standard. The comparison also shows that Cambodia's PEFM system is weak across all three dimensions—budget formulation, execution, and reporting—raising concerns about the capacity of the system to perform the most basic of tasks. At the same time, as in the case of a number of HIPCs, the low initial assessment provides Cambodia with an opportunity to demonstrate future progress both in absolute terms and in comparison to other low income countries.

Source: "Public Expenditure Management: Country Assessment and Action Plan," draft for comment, September 2002, IMF/WB.

4.4 Given capacity constraints the report proposes a gradualist reform strategy. This will entail the operation of parallel systems for several years to come, while measures are gradually taken to delegate responsibility for financial management to the field level, develop adequate systems for cash management, and strengthen the control environment. The temporal perspective is necessarily long term, as the requirements in terms of capacity building are substantial. However, efforts to reduce the fiduciary risk to public funds need to be addressed decisively and with urgency. At the same time it will be necessary to strengthen the reform strategy by improving the accountability of service providers—both direct and indirect—to service beneficiaries. Improving incentives through greater accountability is a promising route to greater efficiency and effectiveness in public spending (see Box 4.2).

Box 4.2: Accountability Mechanisms in Practice: International Experience with Participatory Public Expenditure Management

Broadly speaking participatory public expenditure management (PPEM) involves citizen/beneficiary input at the budget formulation and execution stages as well as at the impact evaluation stage. PPEM has great potential to improve expenditure processes and outcomes in Cambodia. International examples of good practice relevant for Cambodia include:

Pro-poor budget analysis in Gujarat, India: DISHA (Development Initiatives for Social and Human Action) pioneered participatory budget analysis in India in 1992 by engaging in review of budget documents, focusing on agency allocations and their intended beneficiaries and discrepancies between policy statements and actual allocations. DISHA's short "budget briefs," which now number about 30 per year covering agencies most involved in poverty reduction, contain provide budget data and analysis in an accessible form. Observers credit DISHA with improving linkages between planning and budgeting and facilitating the release of funds to priority sectors.

Participatory Budget Formulation in Porto Alegre, Brazil: Porto Alegre, with 1.3 million inhabitants, has developed a highly participatory model of citizen involvement in the budget formulation process, which is usually regarded as the domain of technocrats. Citizens meet repeatedly in formal assemblies during the budget formulation process and are responsible for proposing quantitative rankings of their priorities. An elected Council of Participatory Budgeting proposes revisions to the mayor's budget proposal and lobbies the mayor and the Chamber of Deputies, which ratifies the budget, to adopt a budget that corresponds to the preferences of the citizens. The method is credited with improved outcomes in access to water and sewerage services, school enrolment, road pavement, and even increased tax collections—due to greater transparency and motivation to pay. Over eighty Brazilian cities are now following Porto Alegre's lead.

Government Watch in the Philippines: G-Watch, an initiative of the Philippine Governance Forum, was established in response to the inadequacies of the Government's performance evaluation systems. G-Watch's objectives are to develop a framework for monitoring public sector performance and to engage civil society, the private sector, and the Government in order to institutionalize a monitoring system. G-Watch selected specific projects to monitor and sent investigators out to the project sites to do field work on project status and implementation. Investigators uncovered both incomplete projects—that had been reported as complete—as well as projects that failed to deliver any services at all. The findings were first presented to the Government before release to the public.

These cases are just several among many examples of good practice methods available for increasing participation and accountability in public expenditure management. Others include public expenditure tracking surveys (Uganda, e.g.) and citizens report cards (India and the Philippines, e.g.). These methods would be suitable for addressing accountability issues in Cambodia because they could build on existing civil society networks and initiatives.

Source: Songco, The Participation Group/Social Development Department, World Bank (2001).

ALIGNING RESOURCES WITH POLICIES AND STRATEGIES

4.5 The purpose of expenditure planning and budgeting systems is to align available resources with Government's development objectives, ensuring that agreed policies and implementation strategies are appropriately financed. This section argues that resource alignment cannot be achieved through Cambodia's conventional budget system, which budgets for institutions and inputs. This problem poses a major challenge for further development and implementation of the RGC's poverty-reduction strategy (see Box 4.3 on the linkages between the budget process and the NPRS). Solutions lie in the development of a programmatic budget structure that matches resources with agency functions and management structures, progressive delegation of decision-making and deconcentration of resources closer to the field level, and the adoption of medium-term perspective to resource programming that can facilitate the reallocation of resources and make resource allocation more predictable. Within this broad framework, specific measures are required to ensure that resources are targeted geographically as well as by

function, to make adequate provision for capital and maintenance spending, and to integrate external assistance into the resource allocation process.

Box 4.3: Linking Policies and Budgets: The Case of the National Poverty Reduction Strategy (NPRS)

An important aspect of the poverty reduction challenge lies in the linkage of the NPRS to the budget. In Cambodia the lack of coordination between MEF and MOP meant that the preparation processes for the NPRS and the 2003 budget were not linked. While there is an NPRS chapter on budget allocations and NPRS priorities are generally being accorded budgetary priority, the process for developing these allocations was not directly linked to the NPRS process. The reasons for the disconnect include: (a) the NPRS timetable, which was not built around the annual budget process; (b) the traditionally bilateral negotiations between MEF and line agencies, which are based on line item budgets; (c) the nature of the NPRS process itself, in that line agency proposals were only partially costed and delinked from annual budget preparation; and (d) capacity limitations at the line agency level and in the MOP.

These shortcomings are reflected in several weaknesses in the NPRS process. One issue that affected the NPRS process, highlighted by a recent ODI study (2002), was the absence of clear guidance to line agencies as to the criteria that should be used to prepare proposals. Initially agencies were advised to limit their submissions to limited targeted programs, but were subsequently advised that their submission should reflect their entire programs, highlighting the poverty relevant aspects. Only about half of NPRS policy and program activities were costed. Overall, the NPRS is not fully resourced and any costing were considered preliminary. This to some extent reflects the varying analytical and policy capacity across line agencies, as well as the underlying nature of the budget process.

A disconnect between the PRSP and the budget formulation process is not unusual even in countries where Ministries of Finance do play leading roles in the PRSP process. At the same time international evidence firmly suggests that strong links between policies and programs and the strategic approach set out in the PRSP, and the annual and medium term budget, are critical to the implementation and credibility of national PRSPs.

Source: Klugman and Taliencio (2003).

From budgeting for institutions to budgeting for programs

4.6 For the most part, Cambodia's budget system continues to follow a traditional approach: resources are allocated to institutions through budget ceilings, the institutions prepare bids which comprise a detailed breakdown of the inputs they require, these are then negotiated with the Ministry of Economy and Finance's (MEF) Department of Budget and Financial Affairs (DBFA). The approved budget presents a detailed breakdown of inputs by chapter, distinguishing allocations for salaries and allowances, operating costs, economic and social interventions, and capital. Input allocations are further broken down into sub-chapters, which are used for the purposes of budgetary control, and line items, with a total of forty-three line items detailed in agency budgets for operating costs. Agencies have limited authority to alter the composition of inputs during execution – virement within chapters has to be approved by the Minister of Economy and Finance, and between chapters by the Office of the Prime Minister (OPM).

4.7 While this approach has the merit of facilitating control of agency spending, it has hindered allocative and operational efficiency (as indicated in the World Bank's 1999 PER). Since the institution, rather than the function, is the object of expenditure, the needs of the institution—administrative overheads—have the first call on limited resources, rather than service delivery, and little attention is given to the institutions outputs. Since the institution is a single entity for budget purposes, it is often difficult to target resources to specific functions or departments, line managers may not even know how much money they have been allocated, let alone track the allocation of resources during execution or link resource allocations to the performance of various functions or departments.

4.8 Solutions lie in moving toward program budgeting, in which resources are allocated to support functions rather than institutions, with expenditure programs aligned with

agencies' policy objectives and internal management structures. The first step in a move toward a program budget structure, is to clarify the *purpose of public spending*, the policy objectives and the strategies by which these objectives can be achieved using the available resources. The second step is to *align expenditure programs* with agency management and budget structures. Progress in this regard has already been made in the education and health sectors, where expenditure programs have been aligned with operational management units. The last step is the definition and *monitoring of outputs and outcomes* that programs are expected to achieve. MOEYS and MOH have already developed a comprehensive set of performance indicators for PAP, though these are not yet routinely reported through the budget process.

4.9 The key consideration is how fast the budget can be reoriented toward a program approach. Progress in this area is closely linked to the rolling-out of reforms in budget execution across government since improvements in planning and programming are unlikely to have a significant impact unless they are accompanied by more predictable and timely delivery of funding. Most agencies have yet to address the first steps: design of a policy framework and implementation strategy. Consequently, while progress can be made over the next two to three years in the priority sectors – agriculture, rural development and transport – implementation of a programmatic approach across government is likely to take longer, which is why it is important for the Government to start sooner rather than later.

Programming for investment

4.10 During the 1990s, considerable effort was put into the establishment of a rolling, three-year Public Investment Program, managed by the Ministry of Planning (MOP). This sought to match top-down allocations for investment, based on a macro-economic framework for the budget agreed by the Council of Ministers, with programmed allocations for on-going projects and a prioritized listing of new investments presented by the line agencies. MOP is supposed to appraise line ministries' proposals to determine whether they meet government's development priorities and whether costings are realistic.

4.11 Unfortunately, the PIP has had little impact on the expenditure management process or expenditure outcomes, indicating a lack of progress since the 1999 PER. Project proposals are subject to cursory review. The result is a shopping list of projects. Allocations for capital expenditures, through the budget's Chapter 50, are supposed to reflect the domestic financing requirements identified in the PIP. In practice, no such allocations are made. Instead, the investment budget is managed by the MEF's investment department, with funds allocated to projects approved by the Council of Ministers or the OPM directly. A listing of investment projects is presented in the annual budget, though additional projects are approved in-year. Usually expenditures are posted against the nominally responsible agency, though this is not always the case. Allocations of counterpart funds are made in much the same way. As a result, the recurrent budget process is largely divorced from that of the capital budget.

4.12 The PIP has now lost credibility as a planning tool. Agencies recognize that the PIP plays no meaningful role in investment decision-making, submissions are tardy, with scant information on proposed projects and virtually none on actual disbursements, while preparation and Council of Ministers approval of the annual PIP tends to slip outside the budget calendar or—as in 2001—is dropped altogether. As proposed in the previous PER, with the introduction of the MTEF attention should turn to the integration of the programming instruments.

Programming for maintenance

4.13 Planning and budgeting for maintenance presents a specific set of problems, raising concerns about the sustainability of recent and programmed investments, particularly in road

rehabilitation, but also in the social sectors and in agricultural infrastructure. There are few incentives for agencies to allocate scarce resources to maintenance, partly because of the not unreasonable assumption that donors will cover the cost of rehabilitation once assets have deteriorated.

4.14 In the social sectors, centralization of maintenance functions is impractical. Funds are needed at the facility level to effect minor repairs and undertake periodic maintenance of equipment and buildings. In this context, PAP provides a sounder mechanism for allocating resources for maintenance than the conventional budget mechanism. Allocations for maintenance under these programs are no guarantee that funds will not be diverted to address more pressing needs, but facilities can be required to prepare maintenance plans and central agencies can monitor whether adequate measures are being taken to maintain assets.

4.15 In the case of roads, separate provision for maintenance spending is required if maintenance is not to be crowded out by rehabilitation projects. The recently created Fund for the Repair and Maintenance of Roads provides earmarked revenues for the road network, but in the absence of an appropriate allocational and oversight mechanisms, it has not had a significant impact on road maintenance (see Box 3.6).

Managing external assistance

4.16 Reported external assistance flows in 2001, at US\$ 472 million, exceed domestic revenues, at US\$ 390 million, by a significant margin (see Chapter 2). The bulk of this assistance has been channeled off-budget, both in the sense that resource allocations are not reflected in the Government's budget documents and that funds are not disbursed through Treasury.⁶⁰ Most grant-financed assistance is disbursed through special accounts following donor-specific procedures and so information on actual and programmed expenditures is not captured by Government accounting systems.

4.17 Lack of information and the absence of effective instruments to guide the allocation of external financing seriously undermine the integrity and effectiveness of the budgetary system. At present, it is impossible to assess the impact of external project financing on overall resource allocations, let alone its implications for future pattern of on-budget expenditures, as regards provision for operation and maintenance costs for new investments. There is a considerable risk that the proliferation of donor financed projects has led to policy drift in some instances, by financing investments that are only tangentially related to agencies' development strategies.

4.18 Improving the effectiveness of development assistance will require action by both Government and donors. There is a growing consensus that development assistance is most effective when it is channeled to countries with good policies and effective institutions. In fact, donors, both bilateral and multilateral, are moving toward systems that allocate aid based on country performance characteristics. The World Bank's Country Policy and Institutional Assessment (CPIA) is used to allocate concessional resources to low income countries, while the US Government has recently proposed a Millennium Challenge Account (MCA) for countries that "govern justly," "invest in people," and "promote economic freedom." Cambodia could increase the effectiveness of development assistance and possibly increase total assistance by making progress on good governance and improving administrative capacity. On the donor side, greater coordination with Government and among donors is clearly needed. Donors will also be

⁶⁰ Most donors negotiate their assistance programs with the CDC, chaired by the Minister of Economy and Finance, which acts as signatory to their donor country programs and individual project agreements. Most grant financed assistance is disbursed through special accounts following donor specific procedures. The MEF oversees the disbursement of loan financed external assistance.

challenged to rationalize their salary supplementation practices as the Government moves forward with its civil service reform program.

4.19 At the sectoral level, the solution lies in the further extension of the sector wide approach adopted in health and education, as recommended by the 1999 PER (see Annex C for a complete discussion of progress made on public expenditure management reform since the 1999 PER). In the education sector, considerable progress has been made in the creation of coordination mechanisms involving agency management and external partners. This has helped forge a broad consensus on policy and improve the complementarity of donor inputs. Both the ADB and EU have indicated that they are willing to provide sectoral budgetary support under the right conditions.

4.20 Improvements in reporting on external assistance flows are critical. At present, the most comprehensive source of information on external assistance is the Council for the Development of Cambodia's database. This consolidates information on actual and programmed disbursements of external assistance reported by donors directly. Reporting is patchy and suffers from double counting, but the principal problem is that the database is not compatible with the budget structure. The database's usefulness as a monitoring and programming tool could be greatly enhanced simply by recording the Government's implementing agency for each project.

Formulating gender-responsive budgets

4.21 There is no functional mechanism to ensure that relevant gender issues are incorporated into the planning process or, if identified, are appropriately funded, even though it is clear that women encounter there are major obstacles to priority services for women (see Chapter 3). The Ministry of Women's and Veteran's Affairs (MOWVA), by engaging in three types of activities—influencing national development strategies, influencing sectoral strategies, and implementing projects directly—has made some strides in coordinating public programs important to the well-being of Cambodian women. MOWVA has been less successful, however, in influencing sectoral policies and programs. While there is a reasonably high level of awareness among line ministries of the need to address gender issues, there is little capacity to put this into practice. At the same time, MOWVA has neither the sector-specific skills nor the institutional authority to influence sectoral planning and budgeting. Though MOWVA has established a system of gender focal points in line ministries, the gender focal points tend to be fairly low level staff without decision making responsibilities. As a result, the gender focal points are not effective in mainstreaming gender issues. In fact, the only other national body to have a formal gender mainstreaming strategy, MOEYS, developed it without significant input from MOWVA. Most recently, MOEYS prepared a Gender Mainstreaming Strategy (2002-2006) in March 2002. Despite these promising actions, however, the strategy was neither costed nor developed as part of the ESSP process.

4.22 MOWVA will have to focus on policy analysis as well as advocacy if it is to effectively mainstream gender issues. The recent surge of policy work around the NPRS has provided a first opportunity. Further work on the development of the MTEF and sector programs will provide another. For this to happen, central and line ministries would need to systematically include MOWVA in monitoring efforts and provide it with the information necessary to monitor activities.

Developing a medium term budgeting perspective

4.23 MEF is in the process of establishing a medium-term expenditure framework (MTEF). An MTEF for the period 2003-2005 was presented at the launch of the 2003 budget

process, with further analysis in the NPRS.⁶¹ The MTEF provides projections of the aggregate resource envelope for on-budget funds and resource allocations to institutions. Resource allocations are determined by allocating the increment over the aggregated baseline ceiling, taken as nominal institutional allocations for recurrent expenditures and total capital expenditures in the baseline (2002) budget, with adjustment for projected debt servicing requirements. Forward estimates presented in the MTEF were used to guide the preparation of budget limits for the 2003 budgeting exercise, albeit with adjustments during the budget process. Furthermore, MEF has indicated that it intends to present indicative allocations for outer years, based on the MTEF, as part of the final budget documents, which would make the MTEF an integral part of the budgeting process.

4.24 So far, allocations have been largely determined “top down” and incrementally, reflecting the limited capacity at agency level to structure their budgets by program and prepare realistically costed forward estimates. However, both the health and education sectors have made a first attempt at “bottom up” costing and expenditure programming. This has entailed the formulation of Sectoral Expenditure Frameworks (SEFs) comprising policy objectives, forward estimates for key programs and, in the case of education, output and outcome targets that the sector expects to achieve. Education’s SEF is consistent with PAP sub-sectoral program estimates as reflected in the ESP. In health, the SEF is based on broad programmatic categories: provision of basic services, priority public health programs (incorporating national programs), provision of essential specialized services, and sector wide management activities. These categories are split into sub-component areas and the MTEF will eventually permit the tracking of broad allocations.

4.25 Development of the MTEF will have to be integrated into the MEF’s institutional framework and sector budget/planning cycle routines. The policy orientation of forward expenditure planning requires a range of new skills—in policy analysis, costing and programming. Experience from Africa suggest that MTEF’s may be more effective where existing departments are complemented by new units in order to provide the support necessary for implementation.⁶² Within the MEF, the Economic Analysis and Forecasting Unit could fulfill this function. Across government, the MTEF support structure could be integrated with existing NPRS units and committees. Development of sector expenditure frameworks in the non-priority sectors is likely to be a lengthy process. SEF’s will have to be built on agreed sector policy frameworks and development strategies, and aligned with well-defined and costed programs. Notwithstanding the progress made through the NPRS exercise, many sectors are far from ready. Obviously, priority should be given to the poverty reduction priority sectors identified in the NPRS. However, some consideration should be given to the formulation of expenditure frameworks in those sectors where further savings may be generated, such as defense and security. Without such analysis it will prove difficult to implement a phased reduction in low priority sector without disruption.

4.26 Resource forecasting and in-year predictability in funds release will have to improve if the MTEF is to gain credibility. If there is consistently significant deviation between agreed forward estimates for the priority sectors then agencies will quickly revert to annual budgeting and give scant attention to the preparation of SEFs. This requires high level political commitment to the forward estimates, which entails broad discussion of the MTEF throughout the budget preparation cycle, prior to finalization of budget ceilings, and when budget allocations are finalized. It also means that there has to be a sound basis for projecting future resource envelopes. MEF recognizes that its current models are inadequate and is strengthening its forecasting capability. Most importantly, however, the success of MTEF is dependent on continued improvement in budget execution. It would be difficult indeed to convince line ministries to take

⁶¹ “Medium Term Expenditure Framework, 2003-2005” draft document, 12 September 2002.

⁶² Le Houerou and Taliencio (2002).

three year forward estimates seriously when they are concerned about whether they will receive any funding for the next three months.

4.27 The MTEF should serve as the basis for programming all cross-governmental expenditure policies. Integration of MTEF and the medium term wage framework (MTWF), providing for phased increases in civil service remuneration (see Chapter 5), is critical. Failure to do so runs the risk of undermining fiscal discipline as well as the credibility of the MTEF. Similarly, the MTEF will have to begin to take into account the huge volume of off-budget external financing. Lack of information on actual and programmed disbursements at an institutional level, hinders the integration of external project financing. While improvements are made in reporting at a cross governmental level, Government can take the lead in guiding the external financing by providing indicative allocations by institution and key programs.

Recommendations

- Develop a strategy, based on recent experience, for moving toward program budgeting over the medium term.
- Integrate the PIP into the MTEF.
- Include specific maintenance programs in priority sector under PAP, together with oversight and reporting requirements
- Introduce a formula based allocation mechanisms for road maintenance funding and develop a strategy for conducting financial and performance audits of road fund expenditures.
- Register Government implementation agency and recipient of external assistance in CDC donor financed project database.
- Integrate the MTEF into MEF's institutional framework and existing NPRS/SEDP organizational structures.
- Consolidate the medium term wage framework with the MTEF.
- Provide indicative targets for external financing in MTEF for 2005 budget process.

IMPROVING BUDGET EXECUTION

4.28 The critical test of a public expenditure management system is its ability to deliver a predictable and timely flow of funds to the spending agencies, allowing flexibility in the application of resources while ensuring adequate control at a sectoral and aggregate level. *Cambodia's system does not currently meet this test.* The conventional budget execution system has been effective as a control mechanism, thereby contributing the fiscal and macro-economic stability in recent years, but has failed as a system of delivering resources to spending agencies, resulting in a lack of transparency and a high level of risk (fiduciary risk is addressed in the following sections). Pilot reform initiatives, operating in contravention of key controls laid out in the Organic Budget Law of 1993, have a patchy record in terms of improving resource delivery. Nevertheless, they have considerable support at the level of the spending agencies and have now expanded to cover a considerable share of total non-wage spending in the priority sectors. A unified budget execution system is needed (at the subnational level as well; see Chapter 6). The section concludes by suggesting the design features of a unified system to be introduced gradually over the medium term.

Budgetary performance

4.29 **The effectiveness of expenditure controls at an aggregate level is demonstrated by the Government's success in achieving a current balance of over 1.2 percent of GDP in each year since 1998.** This has been critical in restoring macro-economic stability. Expenditure reports for 2000, 2001 and preliminary reports for 2002 demonstrate that aggregated expenditures have been kept within budget targets (see Annex A Table A17). Furthermore, execution rates have tended to be fairly close to budgeted levels for both recurrent and capital spending. Nevertheless, excess expenditures do occur, notably in 2002 when expenditures salaries and social interventions led to significantly higher levels of expenditures than programmed owing to the implementation of the pay reform.

4.30 **There is considerable variance in budgetary performance against initial allocations at the agency level, however, even though aggregate targets have been met** (see Table 4.1). Central agencies tend to overspend. In 2000 eighteen of the thirty central agencies registered expenditures in excess initial allocations, eight of these had excess expenditures of over 110 percent of their initial expenditure allocations. Central agencies' outturns were much closer to programmed expenditures in 2001, though total excess expenditures were about 70 percent higher than the overspent institutions' initial allocations in both 2000 and 2001.

Table 4.1: Variance in Budget Execution, 2000 and 2001

Execution Indicator	2000		2001	
	Central	Provincial	Central	Provincial
No. Budget Agencies, with	30	20	30	20
Execution >110%	8	1	2	-
Execution >100%	10	1	3	3
Execution <90%	6	12	8	11
Execution <80%	2	1	1	-
Excess & Under spending as % Allocation				
Excess Spending	73.6	30.7	76.5	4.6
Under spending	(7.5)	(40.7)	(5.9)	(11.7)

Source: Bank estimates based on MEF TOFE.

4.31 **For agencies' provincial administrations, the problem is rather one of under-spending.** In 2000, twelve of the twenty agencies with provincial administrations reported shortfalls against provincial administrations' budget allocations, amounting to 40 percent of initial allocations. Provincial execution performance improved markedly in 2001 and 2002, but provinces' execution rates, the proportion of provincial administrations under-spending, and the overall level of under-spending were still worse than for central agencies. Implementation constraints are one factor contributing to the provinces' poorer execution performance, but this may also be also a consequence of the lower priority accorded to provincial governments in allocating available cash. Execution rates have tended to be lowest for provincial operating expenditures, since salaries and social interventions are generally given higher priority when funds are scarce. In contrast, execution rates for PAP have been significantly higher both in comparison to funding for provincial agencies' operating costs and in relation to special program activities at the central level.

4.32 **The large number of excess votes suggests that expenditure controls are implemented selectively.** In-year budget alterations are made to suite changing priorities and to meet pressing obligations. The 2001 commune elections provide a good example—actual expenditures amounted to a reported US\$ 10 million, as compared with initial allocations of US\$

0.7 million—and a salutary warning as regards the impact of the national elections scheduled for July 2002.

4.33 It is noteworthy execution rates for the priority sectors have trailed those for the civil administration as a whole, despite the channeling of a substantial share of sector expenditures through streamlined disbursement mechanisms. This is particularly true of provincial expenditures in the priority sectors, with the exception of education, where provincial expenditures are dominated by payroll costs. In an environment where there is significant overspending at the agency level, the comparatively poor performance of the priority sectors is telling.

Predictability in spending: back-loading and arrears

4.34 Budget execution tends to get off to a slow start, and proceeds erratically thereafter, with significant back-loading of expenditures in the last month of the year. Table 4.2 demonstrates the scale of this problem: in 2000 and 2001 around 30 percent of total recurrent expenditures, and over 40 percent of operating costs, were not posted until December, the last month in the financial year. Again, the level of back loading is higher for health and education than for the civil administration as a whole, and is significantly higher than for defense and security. In 2001, for example, although 92 percent of the budget provision for health was disbursed for the year as a whole, only 2 percent was disbursed in the first quarter of the year, 7 percent in the second, 11 percent in the third, and 73 percent in the last quarter. The situation in 2002 was largely unchanged, with just 8 percent of the allocation disbursed in the first quarter. The pattern in education—indeed across Government—is much the same.

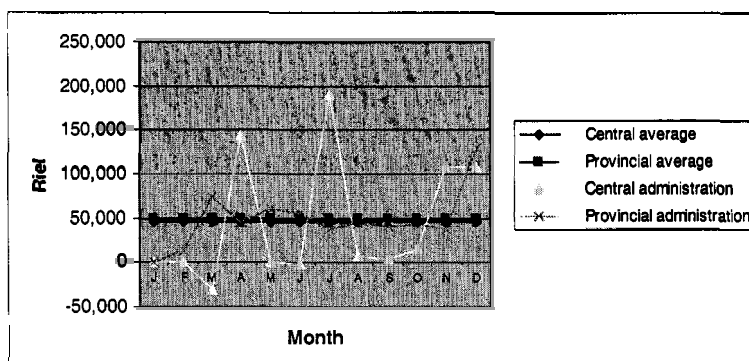
Table 4.2: Back-loading: Share of Expenditure Posted in December, 2000-2001

Economic/Sector	2000		2001	
	Central	Provincial	Central	Provincial
Civil Recurrent	43.4	22.8	31.6	29.9
Ch. 10 Salaries	11.6	19.4	14.1	23.7
Ch. 11: Operating costs	38.2	25.0	42.2	34.9
Ch. 13: Specific Program Activities	47.7	100.00	47.3	70.0
Capital Domestic Financing	10.8		18.2	
Defense and Security	17.2		18.5	
Education	63.2	21.1	34.7	30.2
Health	59.7	31.7	71.4	43.6
Agriculture	41.2	18.6	30.7	28.0
Rural Development	31.5	22.1	13.2	27.4

Source: Bank estimates based on MEF TOFE.

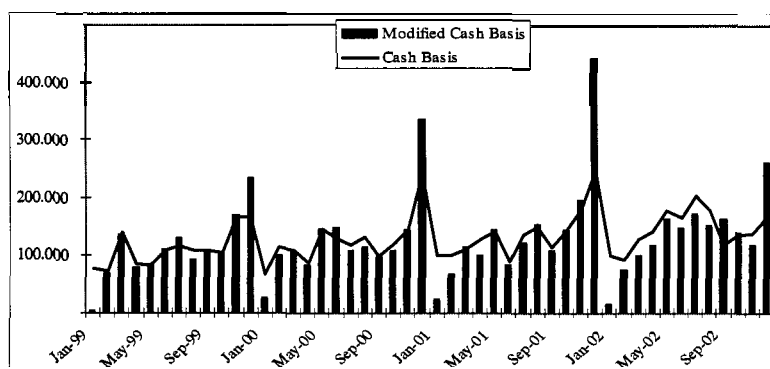
4.35 Back-loading is also a problem for salaries and wages. The coefficient of variability⁶³ for salaries and allowances of central agencies has increased from 38 percent in 1999 to 52 percent in 2001, while variability is higher still at provincial level, rising from 41 percent to 65 percent. Moreover, variability tends to be higher in for the priority sectors than it is for the civil administration as a whole, particularly at the central level (at 122 percent for MOH in 2001, 297 percent for MOEYS and 151 percent for MAFF). Figure 4.1 shows the high variation in monthly salary payments in MOH in 2001.

⁶³ Coefficient of variability is defined as the ratio of the standard deviation of monthly reported expenditures on salaries and allowances to the average. If the monthly reported expenditures were distributed evenly across the year – one twelfth of the total per month – the coefficient of variability would be zero.

Figure 4.1: Monthly Salary Payments in MOH, 2001

4.36 **Back-loading at the commitment stage is accompanied by delays in the release of funds into the following budget year.** In part, the end of year surge is due to clearance of payments of expenditures against the previous years budget during an extended complementary period—so the back loading is actually worse than the data would suggest. However, the extended complementary period, together with delays in payments to suppliers, lead to a flatter aggregate expenditure profile over the year. TOFE reports record expenditures on a modified cash basis (as mandates are authorized) rather than on a cash basis (when payments are made to suppliers). Figure 1 compares the expenditure profile for 1999 to 2002 on a modified-cash and cash basis. Whereas modified-cash expenditures show a stop-start trend with a huge end of year surge, cash expenditures show a much flatter profile. There is still an end of year peak and subsequent drop in expenditures in the early months, but cash expenditures tend to remain significantly higher than those recorded on a modified-cash basis throughout the first quarter as the previous year's mandates are processed and liquidated. As the back loading has increased in recent years, this complimentary period for the closure of previous years accounts has tended to extent—already beyond the one month foreseen in the budget law—into the second quarter. This has had knock-on effects, since mandates from the previous year's budget take the available cash, delaying the liquidation of payments arising from the current exercise, so that in 2002, the budget was operating in net arrears—cash payments exceeded commitments—until September as compared with March in 2001 and February in 2000.

Figure 4.2: Expenditures on Modified-Cash and Cash Basis, by month 1999 to 2002
(CR million)



4.37 **The delayed release of mandates has been accompanied by delays in payments to suppliers, leading to an accumulation of arrears.** In September 2002 Treasury reported arrears

to the private sector and autonomous public agencies of CR 147 billion (about US\$ 37 million), equivalent to 7.8 percent of total spending in that year, of which CR 29 billion predated that budget year. However, the Treasury data are likely to underestimate the extent of the problem, since this covers only payment orders that have been charged against Treasury off-setting accounts. This does not capture arrears to many of the smaller companies in the form of payment orders that they have not been able to cash. Nor does it capture arrears arising from unauthorized commitments made by spending agencies. Discussions with line agencies suggest that agencies do take delivery of goods and services on credit, on the understanding that payments will be made once authorized, in order to bypass the prolonged authorization process.

4.38 Where there funds release is unpredictable, the budget ceases to be a useful planning tool, seriously undermining agency performance and expenditure control. Delays in the approval of commitments and the release of funds prevent timely implementation of agency work plans, undermining the effectiveness of spending in education, where school materials should be available at the beginning of the school year, or road maintenance, where funds should be available after the rainy season. Recourse to unauthorized commitments to by-pass these problems creates another series of perverse incentives, not least of which is the tying of agencies to suppliers with whom they have credit arrangements, thereby hindering attempts to introduce a transparent procurement process.⁶⁴ Agencies have every incentive to withhold and underreport revenues, since this generates cash that can easily be used to finance expenditures.

Constraints in budget execution

4.39 Problems arise at three distinct points in the payments process: the initiation of commitment requests by agencies; the approval of commitments; and the execution of payments.

4.40 At an agency level, the centralization of responsibility for budget preparation and monitoring and poor understanding of budget management procedures are the heart of the problem. Agencies encounter difficulties in initiating and programming payments due to: (a) *late communication of budget allocations*, since agencies only begin to prepare and clear mandates after the budget law is passed by parliament and they have been notified of detailed allocations by MEF, usually in January; (b) *poor expenditure planning*, since agencies do not prepare systematic expenditure plans for budget execution, mandates for expenditures tend to be drawn up shortly before funds are required⁶⁵; (c) *batching expenditure mandates* for submission to MEF particularly where, as in the case of payroll, the preparation and clearance of mandates require information from provinces; and (d) *end of year expensing of budget balances*, as agencies rush to submit mandates for any remaining budget balances, reflecting both inadequate expenditure planning and weak execution capacity at agency level. Moving to a program approach, in which agencies line departments are responsible for preparing budgets and monitoring their implementation, would help integrate budget and operational management. This is a prerequisite for effective budget and procurement planning.

4.41 Excessive centralization of commitment authority at the MEF compounds these problems. Under Cambodia's centralized budget system, all commitments are subject to authorization by MEF financial controllers. The financial controllers fulfill a pre-audit function for the agency that they oversee, this entails verification that the pro forma invoice or requisition presented by the agency has the requisite agency authorizations, that it is reasonable in terms of cost, and that it includes adequate budget coverage and the appropriate supporting documentation.

⁶⁴ See the Country Procurement Assessment Report, forthcoming.

⁶⁵ Moreover, agencies and MEF fail to take into account and prepare for seasonal payments such as the bulk purchase of medical supplies, amounting to about CR 40 billion, half of health sector operating costs, and payments for school examination supervision (around CR 5 billion), which have a significant impact on cash requirements.

Although financial controllers can, in principle, clear commitments up to CR 20 million (about US\$ 5,000), various endorsements are required for most payments, including that of the head of the DBFA, and sometimes including the minister. Inevitably this takes time: agencies complain of frequent delays at this stage, sometimes of weeks or months. It also creates some uncertainty as to whether commitments will be authorized, or released to the agency even if authorized. MEF may decide to retain mandates when it believes that there will be insufficient cash to cover the commitment.

4.42 For the most part, however, delays in budget execution occur at the payment stage, leading to growth in arrears. After agencies confirm the receipt of goods and services, a payment order and supporting mandate are returned to the financial controller for liquidation, confirming the amount of the liability to the supplier. The controller verifies the payment order and authorizing payment, requiring several endorsements. Once authorized, the payment order is submitted to Treasury for payment, or to MEF's Foreign Currency Unit if the payment is in foreign exchange. At this point, payment orders may be retained by either MEF prior to authorization or by Treasury, where there are insufficient funds to cover the expenditure. Again, there are delays, and uncertainty as to whether payments will be effected and the agency is left dependent on gatekeepers in MEF and Treasury.

REFORM INITIATIVES - PRIORITY ACTION PROGRAMS

4.43 Frustration with poor budget performance led MEF, MOH, and MOEYS to find ways of channeling budget funds to priority sectors that by-pass the rigidities, delays, and uncertainties created by this over-centralized budget execution process. These pilot measures, the Accelerated District Development program (ADD) and the Priority Action Program (PAP), have forced some change in spending priorities through a change resistant budget execution system and have thereby ameliorated some of the associated problems. At the same time, they have also created new concerns, particularly as regards the adequacy of controls.

4.44 The ADD program was introduced in 1996 to overcome problems in getting budget funds to the district level. Participating districts physically collected cash from the Ministry of Health in Phnom Penh, by-passing the provincial governors and the provincial treasury system altogether. Operating funds (excluding wages and drugs), which were provided in a single block, could be spent according to district needs. Despite ADD's focus on small disbursements, it introduced a package of modern budget execution principles to Cambodia for the first time. Advance payment via an imprest arrangement, and post-audit of spending rather than pre-audit by MEF, greatly reduced line item specificity in budget allocations. Creation of budget management centers able to decide themselves how to allocate budget funds between the numerous categories of running costs marked a significant deconcentration of expenditure management responsibility closer to the field level.

4.45 A parallel reform, PAP, intended to channel funds directly to health and education spending units, followed in 2000. PAP sought to ensure that high priority activities gained access to their full budget allocation by: (a) removing PAP funding from the discretionary monthly cash allotment system, by providing 25 percent of appropriations for PAP automatically on a quarterly basis; (b) reducing line item detail in the budget for PAP allocations, thus giving greater management responsibility for the allocation of operating costs to spending units; (c) introducing budget management centers (BMCs)—including national programs, hospitals, provincial health departments and operational districts for health, and school districts in education—in spending agencies to manage their own budgets in accordance with pre-approved plans; (d) replacing pre-audit of spending actions by post-audit, a function supposed to be carried out by the

PDAFs for sub-national priority action programs on a quarterly basis⁶⁶; and (e) creating dedicated accounts in provincial treasuries (PTs) that were not subject to discretion over cash release.

4.46 Initially started as a pilot program, PAP has expanded rapidly. PAP was launched in MOH (seven provinces and some national hospitals) and MOEYS (all schools in all provinces). It has since been extended to MAFF and MRD. Furthermore, the amount of funds channeled through Chapter 13 has increased rapidly in recent years. Chapter 13 accounted for just 1 percent of MOH non-wage recurrent spending in 1997, rising to 9.6 percent in 2000 and then to 36 percent in 2001. Even larger increases are reported in education, where Chapter 13 accounted for 37 percent of non-wage recurrent spending in 2001, rising to 67.5 percent in the 2002 budget.

4.47 A recent addition to this multiplicity of budget execution procedures is the Commune/Sangkat Fund (CSF). The CSF was created to finance operating and investment costs of the recently elected commune councils, though it has entirely different expenditure management procedures compared with regular or PAP procedures. The provincial treasuries act as cashiers but authorization of expenditure is solely with the commune chiefs. There is no requirement of “pre-audit” and it is not clear what other audit arrangements will be in place (see Chapter 6).

Assessing the impact of reforms

4.48 At a systemic level, the impact of the reforms is profound, for the simple reason that they do not do not comply with the 1993 Organic Budget Law. While provision is made for imprest accounts for small volumes of expenditure, there is none for the continuous replenishment of advances, nor does the law provide for the delegation of prior review authority to line agency staff.

4.49 There is some evidence that the special Chapter 13 programs have improved budgetary performance against annual allocations. However, this evidence is only consistent for the health sector, where the impact tends to be greater at the provincial level (see Table 4.3). For MOEYS, for which execution data can only be computed for central level allocations, the improvement is less clear cut. What the annual execution data hides is the erratic and back-loaded PAP disbursements. For example, in 2001, delays in the approval of the MOEYS program structure meant that 95 percent of PAP funds were released in only the last quarter. As a result of delays in disbursement, 29 percent of MOH PAP allocations for 2001 were carried over for execution in the following year, together with 44 percent of the allocations for MOEYS at the central level. The disbursement pattern for 2002 shows similar backloading. Moreover, funds have been disbursed sporadically, often monthly, rather than follow a quarterly disbursement pattern. 2002 data also suggests that execution rates vary greatly between provinces – from 56 percent to 85 percent in MOEYS and from 61 percent to over 100 percent in the case of MOH.

4.50 There is no conclusive evidence that PAP and ADD have had a significant impact on agency performance and outcomes. A preliminary review of the performance of PAP versus non-PAP provinces in the health sector found that PAP provinces were more successful on some counts (antenatal coverage), while on others (contacts per capita and rate of attended deliveries), non-PAP provinces fared better. A study of school progression in 2000 and 2001 in MOEYS indicated much lower repeat rates for students in PAP provinces than non-PAP provinces in 2000 due to the additional funds available for remedial teaching, which freed up places for new students. For example, the reduction in first grade repeaters in the 14 non-PAP provinces was less

⁶⁶ Since PAP is not an imprest account arrangement, there is no provision for verification of accounts before replenishment. Instead, mandates are released on the basis of the spending agencies' quarterly cash plan, together with procurement documentation for the prior quarter. The post-audit is supposed to entail a review of these procurement documents.

than 8,000 students compared to about 50,000 in the ten PAP provinces. In the PAP provinces the new first grade intake increased by about 34 percent (60,000 students) as compared to an increase of 7 percent (20,000) in the non-PAP provinces. MOEYS attributes the improved performance to the additional funding provided to PAP provinces for remedial teaching.⁶⁷

Table 4.3: Chapter 13 and 11 Budget Execution 2000, 2001 and November 2002

Economic Structure	2000		2001		2002 (November)	
	Chap 13	Chap. 11	Chap. 13	Chap. 11	Chap 13	Chap. 11
Central Administration						
Education	-	62.0	48.1	77.7	50.0	28.5
Health	93.0	86.1	98.0	93.0	84.4	14.0
Agriculture	-	103.5	70.2	94.0	79.5	41.4
Provincial Administration						
Education	-	121.5	-	108.6	-	53.8
Health	-	66.5	97.8	82.6	86.6	54.6
Agriculture	-	86.4	-	89.3	-	59.6

4.51 If PAP has failed to significantly improve budget execution, this is largely due to the fact that problems of cash management - erratic, delayed and back-loaded disbursement – persisted. However, it is also clear that spending agencies have been slow to spend the funds, resulting in the diversion of some funds to faster disbursing agencies. In many instances local managers, who were used to a pre-audit system, in which responsibility for authorizing spending lay with others, were reluctant to assume responsibility for spending that would now be post-audited⁶⁸. The rapid scaling up of PAP has brought to light significant capacity building needs in the BMCs, in areas such as budget preparation, costing, accounting records and reports, financial control procedures, and control systems. For example, in MOEYS PAP has placed increased responsibility on the Finance Department to supervise, monitor and support the BMCs at the district and national levels. While the Finance Department has increased to 13 staff to monitor and provide support, they are learning by doing and operating with a manual system. Continued strengthening of finance departments' capacity, introducing accounting standards and computerization, developing controller capacity, and improving the capacity of the provinces and districts to maintain records of expenditure are necessary for improving PAP performance.

4.52 Control and accountability for PAP expenditures can only assured where there are effective internal and external audits, yet post-audit capacity is extremely limited in the priority ministries. In MOEYS there have been no systematic post-audits of PAP expenditure since the start of the program, although the MEF controllers at the provincial level reportedly undertake control exercises from time to time. In MOH only a summary statement of spending is required by MEF before release of subsequent cash allotments (supporting documents for each purchase are retained by Provincial Health Departments). Moreover, checking of procurement documentation by financial controllers at the national level (and PDAF at the sub-national level) does not appear to be effectively implemented.

4.53 Although the impact of Chapter 13 reforms has not met expectations, this is due more to deficiencies in the cash management system rather than inherent problems of the PAP and ADD. Certainly, the consensus in the priority sectors is that PAP, while far from perfect, is preferable to the conventional budget execution system. It has given agencies greater flexibility in the use of funds and it has managed to get funds down to the field level. Yet it is clearly unacceptable to operate multiple budget execution systems simultaneously, particularly

⁶⁷ MOEYS, PAP Basic Education 2000 and 2001 Update.

⁶⁸ Cambodian Health Promotion and Primary Health Care Project, A Training Needs Assessment on PAP, April 2001.

where these operate at the margins of the law. As elimination of PAP is not an option, the issue is the transformation of PAP into a mainstream mechanism of budget execution.

BEYOND PAP – TOWARD A UNIFIED BUDGET EXECUTION SYSTEM

4.54 Over the medium to long-term, the objective is to have just one budget execution system in place for non-wage expenditures across the whole of Government. The system should facilitate the release and application of funds by spending agencies, while ensuring adequate control at the agency and aggregate level. Such a system will have many of the features of PAP, including delegated responsibility for expenditure control, a programmatic budget structure, post-audit of expenditures by oversight institutions, predictable release of funds, and flexibility over the composition of spending. The experience of PAP to date indicates that the development of adequate technical capacity at the agency level will be the a constraint in the rolling out the pilot initiatives, since capacity constraints continue to hinder the effective functioning of the new systems in the priority ministries. The strategy must also take into account the risks of a undermining expenditure discipline by proceeding too fast with the delegation to line agencies, without adequate training or the development of supporting control systems at agency level.

4.55 In line with this gradualist approach, this section outlines a strategy that seeks to address some of the shortcomings of the conventional budget execution system, strengthen expenditure management within the existing PAP agencies, and provide a framework for gradually rolling-out the piloted systems across Government.

Improving the Conventional Budget Execution System

4.56 Provisions for the outposting of financial controllers in the organic law have only recently begun to be implemented on a pilot basis in MOH and MOEYS, following the recommendation in the 1999 World Bank PER. The out posting of financial controllers would make them more responsive to the needs of the spending agencies, provide mechanism for capacity building in financial management at the agency level, and allow them to develop a role in support of expenditure programming and planning as well as financial control (though care must be taken to ensure that procedures for out posted controllers do not contradict existing PAP procedures). Outposting is most likely to work where the financial controller becomes accountable to the spending minister, while working under the technical supervision of the MEF, as a cadre of the MEF, though in Cambodia the controllers are still accountable to MEF.

4.57 Significant improvements in performance could be made under conventional budget execution arrangements by simplifying the commitment and payment authorization process. Outposting will only have an impact if the financial controllers commitment authority for individual transactions is increased significantly and the controllers can submit payment orders direct to Treasury and the Foreign Currency Unit. While MEF clearance for larger payments is sound practice, not least to ensure that appropriate procurement procedures are followed, continued centralization of all transactions processing would defeat the purpose of out posting. Communication of monthly or quarterly allocations, which would constitute the aggregate limit for commitments should be sufficient for the purposes of expenditure control, as long as MEF immediately sanctions officials that fail to comply with these limits.

4.58 Further improvements would depend on the development of information systems to support processing and commitment control. Delegation of authority to agencies is only practical where there is timely information on commitments. Where financial controllers are out posted summary reports of mandates submitted, outstanding commitments, and mandates to be submitted in the next three months would suffice. Not only does this allow DBFA verify whether

commitments are within limits, it also provides information on future cash requirements and is an essential part of any cash planning system.

4.59 Budget classifications will have to be improved. The present classifications, focusing on detailed line items, serve little purpose, reduce flexibility, and complicate accounting while contributing nothing to improved control. Since the introduction of new budget classifications requires considerable investments in training across the administration, and will take several years to implement, it is wise to undertake a comprehensive restructuring of the budget classification and chart of accounts. Key features of the revised structure should include an economic/line item classification consistent with GFS standards and provision for program/departmental classification.

Mainstreaming delegated budget execution mechanisms

4.60 The measures proposed above would have a significant impact on the effectiveness of expenditure management systems under PAP as well, but additional measures are required to strengthen and deepen the PAP reforms in the priority ministries.

4.61 As a first step, financial management procedures should be standardized. In the absence of adequate guidance on internal financial operations for PAP from MEF, both MOH and MOEYS have developed their own procedural manuals to guide the budget preparation and budget execution processes. While agencies should be encouraged to develop systems that meet their specific needs, basic procedures should be consistent across government if the integrity of the system is to be maintained. Preparation of appropriate regulations by MEF is a matter of urgency, as PAP is rolled out to MAFF and MRD.

4.62 Computerized accounting systems are also required. Some progress was made by MOH in introducing Peachtree accounting software in the provincial health departments. Computerization of BMC's in MOEYS was rejected on account of the number of units and consequent cost, but reliance on manual accounting systems has hindered timely reporting and tracking on expenditures. Some intermediate level of computerization—between BMCs and provinces—may be viable. Standardization across government, while allowing some flexibility to meet agency needs, is critical. MEF should take the lead in the identification of appropriate software and oversee implementation in priority sectors.

4.63 Streamlining funds release would improve the efficiency of the execution system. Due to liquidity constraints, the quarterly release of cash advances did not function properly. The current design (sub-decree 102) uses tranches to channel resources through PAP, but in practice the number of tranches per year has been quite small. While just-in-time cash releases based on monthly cash plans would be ideal, this would likely be difficult given limited capacity for planning and present liquidity constraints. Pragmatic solutions lie in formalizing the monthly release of funds, while seeking to ensure predictability through a quarterly cash allotment mechanism. It should be recognized that a cash “tranche” regime is an extremely inefficient mechanism for budget execution for a government facing liquidity constraints, draining the Treasury of resources that could be used elsewhere. These constraints can be partially addressed by making proper use of the banking system for funds release and agency payments.

4.64 PAP should also be rolled out further at the agency level, but only where the responsible units can meet clearly defined readiness criteria. The first step in mainstreaming PAP is to roll-out these programs within the priority sectors. At present just seven of the twenty three provinces and municipalities operate PAPs in the MOH. In education, PAP operate across all provinces, but only 144 of the 185 education districts have a BMC. Extension of PAP in both sectors should be phased, both geographically, using readiness criteria to guide the identification of new provinces and districts, and, as the basic architecture of the PAP system is strengthened,

by transferring spending under Chapters 11 to Chapter 13. Institutional constraints can be addressed by applying readiness criteria, which define the minimum requirements before PAP can be launched and for threshold levels of expenditure. These would include: agreement on an appropriate program structure; placement of the financial controller and an adequately staffed and trained financial management unit; establishment and training of BMC staff; and computerization of accounting procedures. Rigorous application of the readiness criteria can be used as an incentive for agencies and—within agencies, provinces and districts—wishing to access PAP funds.⁶⁹

4.65 Before rolling-out PAP beyond the priority sectors it would be wise to undertake a thorough evaluation of its impact so far. This would entail analysis of operational efficiency (especially in terms of timeliness of funds release), compliance (the adequacy of the control arrangements, through an independent audit), and effectiveness both as a tool for delivering resources to service delivery units (through expenditure tracking) and in improving agency performance (through assessment of performance indicators). Ideally, this assessment would be carried out before further budget support significantly increases the volume of funds channeled through this mechanism.

Recommendations

- Outpost financial controllers to MOH and MOEYS and prepare schedule for out posting to other priority ministries.
- Define job-descriptions, institutional arrangements, and authorization procedures for out posted financial controllers.
- Evaluate operational efficiency, compliance and performance of PAP before further expansion of programs.
- Prepare standardized financial management procedures and supporting manuals for PAP, taking account of sectoral variations.
- Review of options for progressive computerization of PAP operations.
- Require preparation of quarterly cash plans for Priority Action Plans and introduce monthly funds release based on a quarterly allocation.
- Define and apply readiness criteria for rolling out of PAP at agency and cross-governmental level.

TREASURY OPERATIONS AND CASH MANAGEMENT

4.66 Cambodia's Organic Budget Law of 1993 provides for a consolidated fund and central payments system, managed by the National Treasury (NT) and its network of provincial treasuries. All revenues should be deposited with Treasury, unless otherwise provided for by law. Treasury should make all payments on behalf of government ministries and agencies, save for petty cash payments through imprest accounts. Payments should only be made on the basis of payment orders authorized by MEF. All payments above CR 2.5 million (about US\$ 600) are supposed to be paid through the banking system. For this purpose, the NT maintains accounts with the National Bank of Cambodia (NBC), the Government's banking agent, together with sub-accounts in the provinces where the NBC has delegations.

4.67 While the Treasury management system provided for in the Organic Budget Law is extremely centralized, subject to problems of delay and gate keeping that characterize

⁶⁹ Strengthening of internal and external control environment is also a priority (see last section).

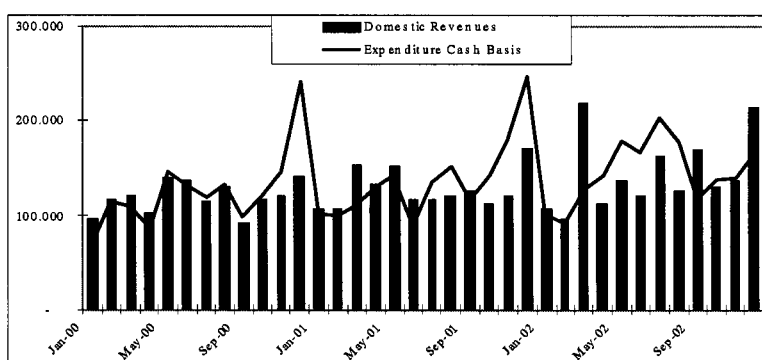
earlier stages of the payments process, it constitutes a sound framework for cash management. The liquidity constraints that lie at the heart of the problems of poor budget execution, both through conventional and pilot mechanisms, can be traced back to the failure of Government institutions to comply with the law's requirements in key respects.

4.68 However, some of the basic systems that should underpin any financial management system are completely absent from Cambodia's National Treasury. There are no standards to govern treasury operations or public sector accounting, except some decrees and *ad hoc* circulars issued from time to time. Nor are there any requirements to audit the accounts. Given the lack of automation, voluminous accounting transactions are carried out by using hand-held calculators or even manually. As in the case of most procedures governing financial operations in Cambodia, the focus of the NT remains on compliance and control through multiple regulations and procedures. The problem is seriously compounded by the absence of regular internal or external audit. Some oversight functions are, however, performed by a number of Government unit through physical inspections of the line agencies. According to anecdotal evidence, this has also resulted in rent-seeking behavior at different levels of financial control, thus encouraging the agencies to flout established rules. Excessive controls seem only to have resulted in strengthening these systematic aberrations. There is also a serious capacity problem of lack of basic skills, which is reflected in the constant revision of accounting data during the year. The present section focuses on these serious shortcomings of the NT and cash management methods and suggests measures that can be taken to bring these practices back in line with sound practice.

Causes of liquidity constraints

4.69 Liquidity constraints are not caused by an uneven flow of revenues over the course of the year (Figure 4.3). At an aggregate level, domestic revenue flows appear to be fairly stable. Government has not had recourse to domestic bank financing to cover an aggregate financing deficit. In recent years, reported expenditure on a cash basis has tracked domestic revenues fairly closely during the early months of the year. This pattern breaks down at the end of the year, when expenditures are significantly higher than reported revenues, and, in 2002, following a significant increase in revenues during the first quarter, which allowed the Government to build up stronger balances. However, over the year as a whole, the Government has sought to constrain expenditures in order to deliver a positive current balance.

Figure 4.3: Domestic Revenues and Treasury-Executed Expenditure (Cash Basis), 2000-2002



Source: MEF TOFE.

4.70 The Government's cash resources are not managed from a single fund as provided for under the law, but are fragmented so that Treasury only has access to a small part of Government's total deposits. At end June 2002 about 10 percent of the RGC's financial assets were available to Treasury for the purposes of budget execution (liquid assets then amounted to

about 6.6 percent of the total Treasury executed budget, riel liquid assets just 2.8 percent). By the end of December, liquid assets had dropped to 5 percent of total assets (see Table 4.4).

Table 4.4: Structure of Government Financial Deposits

Structure of Deposits/ Cash Holdings	No. of Accounts	6/30/2002		12/31/2002	
		M. Riel	%	M Riel	%
MEF Liquid Assets	-	124,116	26.1	79,551	17.5
Central Treasury Cash	-	3,301	0.7	3,686	0.8
Provincial Treasury Cash	-	21,281	4.5	6,634	1.5
Consolidated Fund Account	1	29,154	6.1	9,255	2.0
Other Riel Accounts	2	316	0.1	316	0.1
Dollar Accounts	6	70,063	14.7	59,660	13.2
Earmarked Budgetary Support	-	259,521	54.5	264,740	58.4
Riel Accounts	7	104,978	22.1	153,899	33.9
Dollar Accounts	8	154,543	32.5	110,840	24.4
Project Special Accounts	-	38,312	8.1	70,717	15.6
Riel Accounts	-	-	-	-	-
Dollar Accounts	93	38,312	8.1	70,717	15.6
Ministry Special Accounts	-	53,831	11.3	38,631	8.5
Riel Accounts	10	7,501	1.6	9,034	2.0
Dollar Accounts	49	46,330	9.7	29,597	6.5
Total Government Deposits		475,780	100.00	453,640	100.0
In Riel		166,532	35.0	182,826	40.3
In Dollars		309,248	65.0	270,814	59.7

Source: Bank estimates based on MEF TOFE report for December 2002.

4.71 Agency revenue retention is a major cause of fragmentation. Until recently, tax and customs revenues were retained in separate accounts and released to Treasury periodically. Government has now established a Treasury Single Account (TSA), requiring large tax payers and customs revenues payable in Riel to be paid directly into the Treasury's revenue accounts and for these to be swept into the TSA daily. Eight revenue accounts have been closed. Nevertheless, line agencies—notably the Ministry of Commerce, Ministry of Post and Telecommunications, and MAFF—continue to receive and retain revenues, which are not necessarily fully reported to Treasury, and some of which are held in agency accounts at the NBC. Not only does this hinder the consolidation of available cash, it also undermines efforts to plan and monitor revenue yields for the purposes of forward cash planning. Further efforts are needed to consolidate revenues and establish an adequate reporting framework where there is a legal basis for agency retention.

4.72 Segregation of foreign currency and riel accounts is another source of fragmentation. Foreign currency revenues are surrendered to MEF, whose Foreign Currency Unit is responsible for managing foreign currency accounts and transactions. Deposits in these accounts constituted around half of the MEF's liquid assets at end of June 2002 and over three quarters of liquid assets in December (see Table 4.3). In principle, foreign currency receipts should be surrendered to the National Bank of Cambodia and the TSA credited with the local currency counter value. In practice, these accounts are managed separately, primarily for the purpose of making dollar currency transactions within Cambodia. Mandates and payment orders for foreign exchange transactions—mostly for capital expenditures—are processed through the financial controllers and submitted to the Foreign Currency Unit for payment. There are now transparent criteria for transfers from foreign currency to riel accounts, though such transfers are occasionally authorized when cash constraints become acute.

4.73 By far the largest part of the Government's financial assets at any one point in time is constituted by external budgetary support—amounting to over half of total assets in June

and December 2002. These funds are deposited in special account and earmarked for specific purposes, rather than surrendered to the TSA for the general budget execution. Deposits are occasionally used to replenish Treasury, but they are not readily available, and certainly not managed as part of a comprehensive cash management strategy. On occasion Treasury is required to reimburse advances from the earmarked accounts when funds become available.

4.74 Problems of fragmentation are aggravated by the use of cash for nearly all payments, which results in a systemic weakness that open up avenues for corrupt practices. The exception are salary payments to the Senate and National Assembly and offsetting payments to large suppliers, whereby suppliers' accounts at Treasury are credited against future tax liabilities. The TSA is not used for payments to suppliers by check or bank transfer. Instead, cash is withdrawn by Treasury for payments to be made directly to creditors. Transfers to provinces are similarly made in cash, including those for the payment of salaries. This results in large cash balances being held by central Treasury and provincial treasuries: at the end of June and December 2002, cash holdings were of the same order of magnitude as deposits in the TSA. Additional deposits are held by spending agencies, especially in the priority sectors where the advances for PAP are drawn in cash and held by the BMCs, who then make payments to suppliers. Not only does the widespread use of cash greatly increase the risk of fraud, it makes it difficult to exercise basic controls, such as reconciliation – at the central Treasury, for instance, in and out movements of cash are verified daily but not the stock – and leaves the cash management system hostage to the logistics of shipping large volumes of cash between NBC, treasuries, and BMCs. Inefficiencies will inevitably occur with idle cash holdings balances in some areas that are needed elsewhere. Implementation of PAP has aggravated these problems, by requiring Treasury to mobilize large sums for quarterly advances.

4.75 Cash management is further hindered by the lack of short-term financing instruments for revenue and expenditure smoothing. The Organic Budget Law allows Government to borrow up to 10 percent of revenues for in-year financing. However, Government has made a commitment not to recourse to domestic lending—though this commitment may waver as expenditure pressures mount in the run up to the 2003 elections. Government may also issue short-term borrowing by issuing Treasury Bills. So far, however, Treasury bills have only been issued for the purposes of bank capitalization but the market for such operations is likely to be very limited. Instead, Government tends to rely on non-bank financing—either informally through arrears—or, in the case of investment projects, through pre-financing arrangements.

4.76 Lastly, liquidity constraints have also been aggravated by poor communication between Treasury and the DBFA and lack of effective instruments for in-year expenditure programming. In the past, Treasury has allocated the available cash without close reference to the budget's priorities, often with direct intervention by the OPM and provincial governors determining how limited cash will be applied. MEF created a Cash Management Committee in early 2002 to address these concerns. Cash projections were prepared for central and provincial administrations by month for the whole of the year, and the committee has monitored implementation in relation to the plan. However, the Committee has yet to assume an active role in scheduling the authorization of mandates, thereby ensuring that commitments reflect projected cash balances and reducing the risk of arrears, and in prioritizing the payment of suppliers. This is partly because, in the absence of a systematic registration of mandates in a database, it is difficult to identify which mandates and the volume of commitments that are outstanding and are being processed through the system at any one time. Nor, given the limitations of revenue projections, does the Committee have access to reliable forward estimates of receipts.

Toward a strategy for improved cash management

4.77 While increased use of the banking system must constitute the core of any program to strengthen cash management, this will have to be phased in gradually. Scant use is made of the banking system for private sector transactions, particularly in the provinces, partly because distrust of the banking system is deep-rooted, and has been aggravated by instability in the banking sector in recent years, partly because the use of banks provides opportunities for another group of gatekeepers, and partly because of the sparse banking network outside the main urban centers. Similarly, while use of a single, national currency for Government transactions is highly desirable, this too is likely to encounter resistance from the private sector. Cambodia is a highly dollarized economy, and though riel may be used more widely in rural areas, the dollar still remains important as a store of wealth.

4.78 Within Government it is impractical to design reforms simply in terms of implementing the provisions of the 1993 Organic Budget Law. Introduction of PAP has led to a delegation of the payment function from Treasury to the spending agency that it would prove difficult to reverse in the medium term. In this context, a program of reform for measures to strengthen cash management will have to address a range of institutional constraints over the medium-term. Such a program should focus on: (a) increasing the use of the banking sector for budget execution; (b) further integrating the Treasury system, especially with regard to foreign currency operations and revenues; (c) improving planning and prioritization in cash management; (d) revamping earmarking practices; and (e) improving management information systems.

4.79 Making increased use of the banking system for budget execution transactions, including PAP, is a priority measure. MEF recently indicated that NBC will begin to make transfers to some provinces through its provincial branches from early 2003. This is an important first step. It is also important to begin using the banking systems for payments. This could be achieved by requiring that all payments above a certain level (the law states CR 2.5 million) be made by check or bank transfer. The extensive use of the banking system by the World Bank and other donors projects demonstrates that this is feasible, though NBC's capacity needs to be strengthened as well. PAP agencies should also begin to use the banking system for payments. This would be possible by establishing sub-accounts with the NBC at central and provincial level, and by selective use of the private banking network (as the NBC does not have delegations in most provinces). Ideally, PAP accounts would function on the basis of a zero balance, cleared regularly, however, if this is not feasible, monthly replenishment is advised.

4.80 Further integration of the Treasury system is necessary to reduce the fragmentation that impedes effective cash management. Integrating foreign currency operations should start with the integration of information on foreign currency balances into the MEF's cash management plan. Over the medium-term, the Foreign Currency Unit and its functions should be transferred to Treasury. At the same time a progressively larger share of revenues should be paid through the banking system to TSA sub-accounts, and procedures for the timely surrender and reporting of agency revenues need to be clarified.

4.81 Improving forward planning and prioritization in cash management is another key reform measure. At the agency level, attention needs to turn to in-year programming of expenditures and procurement planning, so as to provide an informed basis for cash planning at the central level. Agency's should be required to report monthly on the commitment mandates submitted, mandates authorized, payments falling due, and mandates to be submitted in the next three months. For MEF, and the Cash Management Committee, forward cash plans should be regularly updated. These should provide broad guidance on Treasury's prioritization of payments and identify specific payment orders to be expensed as a priority. PAP release procedures also need revision. As the share of expenditures passing through PAP increases, it will become

impractical to provide quarterly cash advances. Monthly advances are feasible and could actually improve predictability if accompanied by quarterly cash allotments that serve as a guide to the volume of monthly releases.

4.82 Given the legal requirement for consolidation of funds, earmarking should be strictly limited to those earmarked revenues provided for in legislation and by financing agreement. All other earmarking arrangements should be terminated. Additionally, the revenues and expenditures associated with authorized earmarking arrangements should be clearly identified in budget documents and the TOFE report.

4.83 Lastly, implementation of a computerized information system for Treasury operations and MEF commitment controls is needed. A simple accounting system would allow Treasury to compile basic accounting registers, such as cash books and ledgers, by automating existing manual procedures. For MEF, while financial controllers are still based in the DBFA, information systems for tracking mandates and commitments are critical, since this is the only way to provide information on outstanding obligations for the purposes of cash planning.

Recommendations

- Define and apply threshold for national and provincial Treasury expenditure operations to be executed by check or bank transfer, and use banking system for all intergovernmental transfers.
- Undertake an inventory of all revenue accounts and draw up a schedule for the elimination of revenue retention accounts that have no basis in law.
- Review of requirements for computerization of national and provincial Treasury operations.
- Integrate information on foreign exchange balances in MEF/Treasury cash management plan.
- Consolidate revenues into Treasury Single Account, other than those with legal basis.
- Require agencies to present commitments, outstanding commitments, and accounts payable in their monthly financial reports.

STRENGTHENING TRANSPARENCY AND ACCOUNTABILITY

4.84 Cambodia's budget law, which is complemented by a series of decrees and sub-decrees, establishes a sound legal framework for oversight of the public expenditure management system. Key features include requirements for: review and approval of the budget by the National Assembly; all revenues and expenditures of the government to be included and reported separately in a single budget document; submission of all revenues to Treasury; the separation of responsibilities of authorizing officers and payment officers; presentation and audit of annual financial statements. Budget documentation includes a detailed presentation of projected revenues and the proposed application of funds by central agencies and provinces.

4.85 However, in spite of a comprehensive legal framework, the multiplicity of controls, and the centralized nature of the expenditure management system, weak financial management practices still undermine transparency and accountability, posing serious fiduciary risks. A sound internal control environment requires not only an appropriate legal framework but also an organizational culture of compliance with the law, ethical and professional standards, a motivated and competent civil service familiar with rules and regulations that they are expected to apply, management systems that provide timely and accurate information for decision making, and appropriate oversight arrangements. While the legal framework is sound,

the Cambodian internal control environment lacks many of the above requirements. This section examines the underlying causes of these risks and the measures that may be taken, over the medium term, to strengthen expenditure and financial management.

The internal control environment

4.86 In recent years, agencies have adopted a number of practices that facilitate their operations but do not comply with the principles or requirements of the Organic Budget Law. Some of these practices are officially endorsed, while others merely tolerated. Not only do these practices create fiduciary risks—notably regarding the large amount of cash circulating in the expenditure system, which makes it difficult to reconcile accounts, and the inadequate reporting of agency revenues—they undermine the rationale of rule-based expenditure management. Indeed, officials routinely and innovatively circumvent rules to facilitate budget execution. Use of informal credit arrangements with suppliers, for instance, allows agencies to procure goods and services in anticipation of future payment, at higher cost, but also in contravention of procurement rules. Agency officials exchange cash advances into dollars to make payments to suppliers, sometimes changing dollars back into riel when payments have to be made in local currency.

4.87 Despite the efforts of the MEF, notably through its training institute, staff are poorly trained, particularly in basic financial management skills, and unfamiliar with the regulations they are supposed to apply. There are no minimum qualification requirements for technical staff, nor are there recognized professional qualifications in the field of accounting and financial management. A generation of skilled personnel that would occupy senior management posts today was lost during the Pol Pot regime.

4.88 Within this weak control environment, multiple controls have created a series of gatekeepers throughout the expenditure management system: in agencies, in MEF, in Treasury, and in the banks. The result is increased probability of corruption. Gatekeepers have little incentive to facilitate operations: they may be risk averse, referring the smallest matters to their superiors for decision, causing excessive delay. In the worst cases they may be corrupt. There is a general acceptance, based on widespread anecdotal evidence, that “facilitation” of transactions is a common necessity (see Box 4.4).

Box 4.4: A Tradition of Rent-seeking?

A Cambodian newspaper recently reported that provinces and municipalities are required to make payments to officials in MEF, NT, the Ministry of Interior (MOI), as well as local banks, in order to secure release of cash for municipal and provincial expenditures, and claimed to have to documentation to prove its allegations. “‘It is true that we have to pay people for their services to the relevant ministries,’ said one official in the Kep municipality. ‘If we do not pay them, it is hard to get the funds or we receive our funds too late.’” About 30 percent of appropriated funds are “‘going into everyone’s pocket in the ministries even though the funds are for development,’ the official said. ‘It’s a tradition.’” According to the press account, “Other provincial leaders confirmed that they too were ordered to pay a certain percentage of their development funds to the ministries.” In one case it was reported that payments were made throughout the system, to MEF (about 5 percent quarterly), MOI (about 5 percent), NT (about 2 percent), and PDAF (about 1.3 percent). Asked for clarification, MEF asserted that this account was neither truthful or accurate.

Source: The Cambodia Daily, December 5, 2002, page 1.

4.89 Government is aware of these problems. Chapter 11 expenditures are identified as being a particularly high risk, since it is here that agencies have adopted informal practices to facilitate budget execution. Concerns have also been raised regarding PAP expenditures, owing to the absence of effective pre- or post-audit reviews. However, rarely have civil servants been dismissed—one recent case was identified related to the dismissal of a personnel officer for payroll fraud—let alone subject to criminal proceedings.

4.90 **There are no immediate solutions to these systemic problems, though greater attention to the gravity of the fiduciary risk problem would likely galvanize efforts to improve transparency and accountability.** MEF's strategy is to gradually strengthen the internal control mechanisms at agency and central level. Significant progress can also be made by making the public expenditure process more transparent and improving downward accountability to clients. These technical improvements are an essential part of any solution. However, in the end, high level political commitment will be needed to identify and sanction cases of corruption, reward good performance, and gradually instill a culture of compliance and performance throughout the administration. Civil service reform is a prerequisite for successful financial management reform (see Chapter 5).

Public accounting

4.91 **The Cambodian financial accounting system, as currently practiced, does not meet with any acceptable accounting standards and neither provides accurate nor timely information necessary for the financial management of a modern state.** The system has evolved over the years and is primarily based on French accounting principles. However, over time, other accounting conventions have been adopted either due ideological reasons (Soviet conventions during Khmer Rouge regime) or in response to changing fiscal management requirements. Over time the system has deteriorated owing to the successive crises and incompatible systems imposed on this basic model. The lack of attention given to the system over the years has led to an inability to respond to the increasing demands of budget management in particular, because basic systems, such as a standardized accounting methodology, do not exist. Moreover, the system is manual; there is an extremely low level of automation in the NT and PTs. The result is the system that provides late, incomplete, and inaccurate information.

4.92 **Responsibility for accounting rests with the NT and its provincial branches.** Treasury prepares trial balances daily, based on statements from the NBC and records of movements against accounts and cash transactions, together with monthly financial reports, for internal purposes. Both line agencies' Departments of Administration and Finance and MEF financial controllers maintain records of mandates issued and cleared, but neither the agencies nor MEF keep a database which would allow them to track these transactions or consolidate commitment records. Agencies are also supposed keep record of expenditures and prepare monthly reports, though this practice does not appear to be systematic, indicating a lack of progress since the 1999 PER.

4.93 **The chart of accounts, established in 1994 and subsequently adapted to accommodate changing expenditure management practices, does not provide a satisfactory framework for consolidating information on revenue and expenditure operations.** These are used as the basis for a final balance, presented to the National Assembly about six to nine months after the end of the financial year. Weaknesses in the current system include: (a) poor coverage, as the Treasury system fails to capture large volumes of transactions (operations in foreign currency, those using retained revenues and earmarked funds, those arising from PAP advances); (b) lack of reconciliation of flows and stocks (moreover, reconciliation of banking information does not appear to be systematic), including between Treasury and line agency reports; (c) use of offsetting arrangements, whereby suppliers accounts in Treasury are credited with payments and debited for tax, which undermines transparency; (d) lack of detail (control accounts have few subsidiary ledgers for analysis); (e) poor articulation with the expenditure system (the accounting system records transactions at the payment stage, with little information on commitments); (f) poor integration of provincial treasuries, leading to delays and difficulties in consolidating accounts; (g) use of a largely manual system, generating considerable risk of computational error; (h) lack of a comprehensive accounting manual detailing policies and procedures supplementing

the diverse decrees and sub-decrees for expenditure management (as a result practices may vary among provincial treasuries); and (i) the focus on pre-audit, which leads to superficial verification of supporting evidence for the completed transactions.

4.94 Government's main financial report, the Table of State Financial Operations (TOFE), prepared monthly by MEF, is made available to an external audience, including the National Assembly and external partners, and will soon be posted on the MEF website. While the timeliness and detail of reporting is far superior to that found in many low-income countries, the TOFE suffers from the weaknesses of the underlying Treasury accounting system and difficulties in reconciling the various sources. Moreover, as a tool for expenditure monitoring the TOFE is deficient in three respects. First, presentation on a modified cash basis effectively captures commitments but can give a false impression of progress in budget execution. This is particularly true at the end of the year when mandates continue to be authorized and expensed during an extended complimentary period. While adjustment is made at an aggregate level, it is not possible to determine actual expenditures against individual agencies. Second, there is no explicit link between earmarked revenues and associated expenditures. Given the size and strategic importance of some of these earmarked funds, notably the FRMR, this is a significant omission. Third, the treatment of capital expenditures is unclear, for the most part these are presented only at an aggregate level and, where pre-finance operations are used, the actual expenditures are significantly lower than stated on a modified cash basis.

4.95 Given these shortcomings, the accounting system does not meet acceptable accounting standards and cannot provide assurance that public funds are used for the purposes intended. Under TCAP, the RGC has set up an Accounting Reform Group. Three priorities have been identified: reformulation of the chart of accounts, consolidation and reconciliation of accounting information, and the computerization of Treasury operations. So far, progress has been slow, as the group has become bogged down trying to resolve too many theoretical and practical issues simultaneously. A more pragmatic approach would involve focusing on basic procedures and information accuracy before tackling more complex issue of accounting principles and standards.

4.96 The main objective of the first phase of the reform program should be to produce accurate accounting information based on a unified chart of accounts. This will be easier to implement if there are no changes to the current budget classification, budget execution rules, or the payment system over the short-term. The following implementation program is recommended: (a) definition of an acceptable set of accounting policies and procedures (based on international standards) to be used in preparation of government financial statements (the priority is to clarify the procedures to be applied following existing financial management practices); (b) preparation of a revised chart of accounts combining the current budget classification coding of revenue and expenditure and treasury accounts, and expanding the asset and liability accounts to include all government transactions, together with simple reporting formats⁷⁰; (c) development of a simple accounting manual fully explaining the linkage of new chart of accounts to budget classifications and providing clear rules for coding of financial transactions, followed by adequate training.

4.97 Computerization is critical to the timely, accurate preparation of accounts based on transaction information and the ability to reconcile between accounting records. This is feasible using a fairly inexpensive, standalone PC accounting software package in both national and provincial treasury offices. Training needs should not be underestimated: staff in the national and provincial treasuries would need training in the use of the computerized accounting system.

⁷⁰ Over the medium-term, attention should be given to the reformulation of the chart of accounts, including a revised budget classification consistent with GFS standards.

Fairly quickly it should be possible to generate all government financial statements from a computerized system. Although an integrated financial management system should be the ultimate goal, the technical competency of staff and current development of accounting rules and regulations do not warrant embarking on a complex system for the time being.⁷¹

Development of oversight arrangements

4.98 Though there has been progress in improving the audit function, public oversight of government financial management remains extremely weak. Legislation establishing the National Audit Authority (NAA) was passed in March 2000, providing for an institutional framework, responsibilities, and competencies that are consistent with international standards. The NAA is independent of the executive, reports to the National Assembly, enjoys financial and administrative autonomy, and is authorized to determine the scope and methods of audits. An Auditor-General and two Deputy Auditor-Generals are appointed for five year terms by royal decree at the recommendation of the Government and approved by a two-third majority vote of the National Assembly. The current Auditor-General is from the CPP, and the deputies from minority parties. The NAA carried out an audit of the year 2001 budget implementation (MEF's Budget Settlement accounts) as its first audit assignment.⁷² The audit was completed in September 2002 and was submitted to the National assembly. However, the report has yet to be made public.

4.99 As a young organization with a clearly defined mission, NAA appears to be well motivated. However, NAA acknowledges that a considerable amount of on-the-job training and further investment in equipment, including computers, is required for it to be fully effective.⁷³ The ADB is supporting with technical assistance in training. Under the original program put together by ADB, training in theory and practice spanning 12 and 16 months respectively were planned. However, due lack of technical assistance resources, this has not taken place. This should be considered a priority, since the audit function is critical in ensuring adequate oversight.

4.100 In parallel with the creation of the external auditor, the RGC has sought to build up its internal audit capacity. MEF's General Inspection Department undertakes compliance audits at the agency level, though it does not appear to have an audit program. Line ministries have also been encouraged to establish internal audit units.

4.101 Legislative oversight of public expenditure is provided by the National Assembly's Finance and Banking Committee (FBC), and the Assembly as a whole, though the link between legislative oversight and greater accountability is weak. The FBC reviews the RGC's budget proposal and financial statements before submitting them to the plenary session. The FBC has also received advice from an independent think-tank, the Cambodia Development Research Institute, on the Government's budget proposals. While there is active debate on budgetary issues, the FBC's deliberations are neither public or published. The draft budget law are voted in plenary sessions after Government presentation and cursory debate. Though parliamentarians and senators have the authority to propose reallocations to the budget law, they rarely do so. These debates are reported in the local press. For the most part, however, press coverage has tended to

⁷¹ The World Bank has successfully assisted in installing stand alone PC-based computerized accounting systems for project accounting in Cambodia. Cambodian technicians have used simple software (such as Peachtree) unaided after basic training. A more complex project uses Solomons software and is operated by Cambodian staff with the assistance of one expatriate accountant. Similar systems are now being piloted in seven RILGP provinces to manage CSF accounts (though not for the entire PT).

⁷² The NAA has adopted International Standards of Auditing, as Cambodia does not yet have national standards, and has joined INTOSAI (International Organization of Supreme Audit Institutions).

⁷³ The World Bank's peer review of the NAA recommends that the NAA not be used for the audit of Bank projects at this time.

focus on investigations of corruption in the public sector rather than broader expenditure policy issues. Moreover, in past years the Assembly has been given too little time to review the budget in detail. Typically the draft budget law has been presented in mid November for adoption by the end of December. The Assembly and the Government agreed that in 2003 the budget law will be presented in mid October. Providing adequate lead time is necessary, though not sufficient, to enable the National Assembly to fulfill its oversight role. Strengthening the FBC's capacity—through technical assistance as well as hiring of staff with the requisite skills—to review the budget law would help it to hold the Government to a higher standard of accountability.

4.102 While oversight arrangements are fairly sound, their effectiveness is severely limited by capacity constraints. These will have to be addressed over the medium to long-term, by increasing both the numbers and in-service training of financial management personnel. In the meantime, the effectiveness of existing oversight arrangements could be greatly improved by ensuring that the NAA's audit reports are made available publicly. Moreover, attention should be given to the development of "bottom-up" oversight arrangements to complement formal oversight by elected representatives through NAA and the National Assembly.

Recommendations

- Define an acceptable set of accounting policies and procedures for existing expenditure execution procedures, including PAP.
- Prepare a simple accounting manual, providing clear rule for coding of financial transactions and underlying procedures.
- Prepare a modified chart of accounts covering all government financial operations (alongside PAP manual).
- Review requirements for computerization of National and Provincial Treasury accounts and financial reporting based on a modified chart of accounts.
- Develop and arrange financing for a medium-term capacity building program for the National Assembly's FBC.
- Develop and arrange financing for a medium-term capacity building program for NAA.
- Ensure that the Government's financial statements are audited annually by the NAA.
- Publish the audited financial statements and make them accessible to the public.

CONCLUSION

4.103 It is clear that weaknesses in the PEFM system have high costs in terms of allocative and operational efficiency while also creating unacceptably high levels of fiduciary risk to public funds. Indeed, in comparative perspective, Cambodia's PEFM system is considered weak. The paradox is that in spite of the multiplicity of controls and the centralized nature of the PEFM system, weak financial management practices pose serious fiduciary risks. The fundamental problems result from a weak control environment, severe weaknesses in Treasury operations, especially in the area of cash management, inadequacies in the public accounting system, and weak internal and external auditing and oversight. These problems are so serious that the Government's system cannot be relied upon to expend resources in an accountable manner. These systemic weaknesses raise concerns about fiduciary malfeasance and increase the likelihood of corruption. Comprehensive PEFM reform, strengthened by effective accountability mechanisms, offer the way forward.

5. REFORMING INSTITUTIONS TO IMPROVE SERVICE DELIVERY II: THE CAMBODIAN CIVIL SERVICE

*“Yet, recognizing that adequate remuneration is central to the future of reforms and to the Civil Service becoming an effective provider of public services and a reliable development partner, the Government is systematically investigating ways and means to accelerate pay reform within the confines of macro-economic stability, sound fiscal management and sustainability. Every possible avenue will be explored and there is no panacea (emphasis added).”*⁷⁴

INTRODUCTION AND REFORM AGENDA

5.1 The Royal Government of Cambodia’s (RGC) commitment to poverty reduction requires a public sector able to deliver a high quantity of high quality services across the national territory, including rural areas where many of the poor reside. The civil service is the institution that is charged with transforming Government and donor resources into poverty-reducing services. Civil servants are the link between resource delivery and service delivery. Yet given the serious challenges, widely acknowledged by the RGC, donors, NGOs, and Cambodian citizens, afflicting the civil service—low pay, low skills, and thus low capacity—*comprehensive civil service reform will have to be accelerated in the short term and carried out over the medium term if the Government’s vision of poverty reduction is to become reality.* Indeed, one of the principal risks to the NPRS is the capacity of the civil service to deliver. Moreover, it is clear that low public sector wages provide a breeding ground for corrupt practices. At the same time it is apparent that low pay is a leading cause of Cambodia’s relatively poor standing on public sector performance among its peers. The World Bank’s Country Policy and Institutional Assessment (CPIA) ranks Cambodia in the fourth lowest quintile among fellow low income countries on issues pertaining to public sector management and institutions, indicating significant room for improvement.

5.2 Though the problem of civil service reform is widely acknowledged and there is growing consensus on the path reform will have to take, the *pace* of reform will have to quicken and the *scope* of reform will have to be expanded if service delivery is to improve in the medium term. The RGC has outlined its goals for civil service reform through the National Program for Administrative Reform (NPAR), and its implementation strategy through the Strategy to Rationalize the Civil Service (SRCS), approved by the Council of Ministers in October 2001 (See Table 5.1). However, the RGC also recognizes the need for a more far-reaching approach. The NPRS rightly asserts that “every possible avenue” will have to be explored. Simply put, without comprehensive civil service reform, it will be difficult for the Government to implement its poverty reduction agenda.

⁷⁴ “Cambodia: National Poverty Reduction Strategy,” December 2002, p. 102-103.

Table 5.1: The National Program for Administrative Reform and Strategy to Rationalize the Civil Service, 2002-2006

Goals	Desired Outcomes
1. Accelerate pay and employment reform 2. Reorganize and redeploy staff to priority areas 3. Improve service delivery 4. Strengthen capacity to plan and manage the administrative reform	<i>Improved Quality of Public Administration</i> ➤ Ability to document and control the composition and distribution of the civil service ➤ Essential instruments to manage and motivate personnel <i>Empowerment of Civil Servants to be More Effective and Productive</i> ➤ Increase civil service salaries in line with available resources ➤ Gradually decompress the wage structure ➤ Increase competitiveness of civil service remuneration and recruitment <i>Promotion of Transparency, Responsibility and Ethical Behavior</i>
Strategies	
<i>Improved Quality of Public Administration</i>	
1. Develop and operationalize a Human Resource Management Information System. 2. Improve management of payroll, including automation. 3. Introduce new employee classification system in order to promote staff based on performance and seniority. 4. Meet needs of ministries relating to corporate (back office) services.	
<i>Empowerment of Civil Servants to be More Effective and Productive</i>	
5. Maintain workforce stability by increasing size of civil service by only 0.3% between 2002-2006. 6. Increase average civil service pay. 7. Introduce a system of allowances targeted to priority tasks and functions. 8. Implement Priority Mission Groups. 9. Undertake further analytical work to investigate ways and means to accelerate pay and employment reform, including an operational review/functional analysis and options for establishment control.	

5.3 The nature of the constraints on civil service capacity requires a comprehensive approach. Such an approach would: (a) *improve civil service pay*, to attract and retain skilled staff who would work the required hours in the required locations, especially for high level management and priority sector staff; (b) *rationalize civil service employment*, to ensure that human resources are wisely deployed in high priority sectors and administrative functions; and (c) *strengthen civil service management*, to guarantee that human resource expenditures are subject to controls (viz., on hiring and promotion) and linked more closely to the budget formulation process. In some of these areas, such as workforce control, key measures such as the introduction of an establishment register, would allow the Government to build productively on its previous successes, while in other areas, notably pay and employment policy, the Government will be challenged to push itself farther and faster than currently envisioned.

5.4 Given the gravity of the problem, the RGC committed in 2002 to an accelerated program of civil service reform that adequately addresses the problems of low pay, weak administrative capacity, and the need for employment rationalization. The reform program—scheduled to be completed in early 2004 in time for the new Government to take concrete steps forward—will build on the SRCS. The RGC, based on its Governance Action Plan (GAP) and the National Program of Administrative Reform (NPAR), has made notable progress in the following key areas: (a) *civil service remuneration*, in which average monthly pay increased to approximately US\$ 33 as a result of the introduction of a new classification system in 2002

(according to 2002 budget data); and (b) *documentation and control of the workforce* by carrying out a census, completed in 2000, that identified a reported 9,000 “ghost” workers and issuing civil service identification cards, by developing an automated payroll system (with automatic production of payroll lists), as part of the Human Resource Management Information System (HRMIS), and by solidifying the legal framework to cover all civil servants under the Common Statute. The RGC will also undertake additional initiatives in 2003, such as the Priority Mission Group (PMG) program.⁷⁵ Thus, while the RGC has undertaken important reforms, much more remains to be done.

5.5 The chapter begins by providing a brief overview of the Cambodian civil service in comparative context before addressing, in turn, (a) pay reform, (b) employment reform, (c) medium term pay and employment reform options, and (d) human resource management.

CAMBODIA IN INTERNATIONAL PERSPECTIVE: THE COST AND SIZE OF THE CIVIL SERVICE⁷⁶

5.6 Compared to its low income country peers, the Cambodian civil service is about average in terms of cost (the wage bill as a percentage of GDP, current expenditures, or revenues) and size (civil servants as a percentage of population). In recent years Cambodia’s total wage bill, which includes defense and security expenditures as well as civil administration costs (the latter include the salaries of elected officials in the executive and legislative branches, as well as the judiciary) averaged 3.90 percent of GDP (1999-2002), including salaries, allowances, and supplements, declining from 4.12 percent of GDP in 1999 to 3.64 in 2002.⁷⁷ The comparison with other low and lower middle income countries for which recent data is available shows that Cambodia falls toward mid-range and just slightly below the set average of 4.5 percent (the low income country worldwide average is 5.4 percent). As a percentage of current spending, Cambodia falls just slightly below the set average of 39 percent (Figure 5.1). Both relative cost indicators show that Cambodia’s total spending on wages is not inadequate by international standards.

5.7 In terms of the wage bill as a share of revenues, Cambodia, at 33 percent, falls slightly below the low and lower middle income country average of 37 percent (Figure 5.2). This would suggest that Cambodia is not an outlier either in terms of over- or under-spending on the wage bill relative to resources; Cambodia falls in the mid-range where most of the countries in this sample cluster. However, it does suggest that for Cambodia to increase the wage bill significantly, it would have to increase revenues, both tax and non-tax, significantly. To move

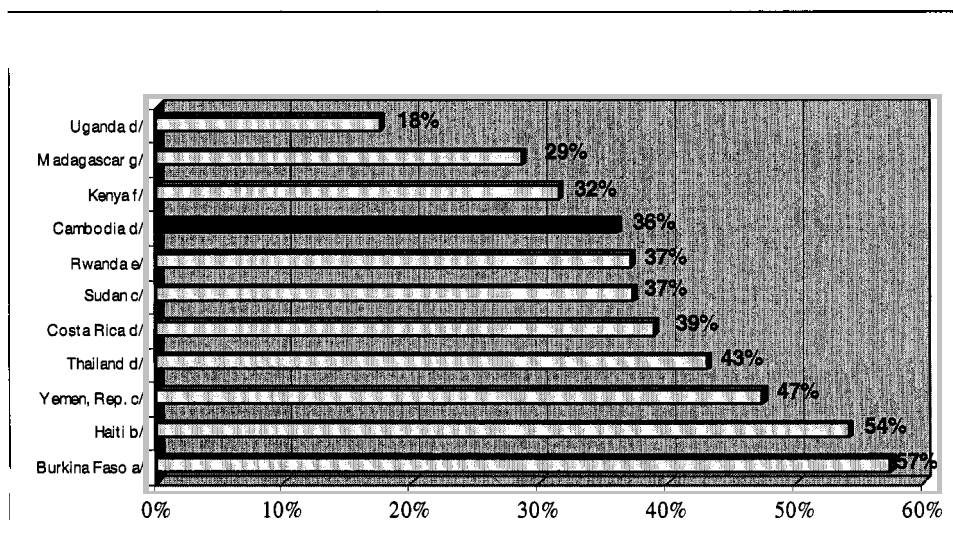
⁷⁵ Starting in 2003 the implementation of the Priority Mission Group (PMG) program will begin to address major service delivery bottlenecks, with the first PMGs targeting change initiatives underway. PMGs are groups of civil servants who will be tasked with focusing on identified “priority missions.” To motivate these groups, they will be provided with special monthly allowances, depending on the staff’s category, ranging from CR 190,000 to CR 520,000 (approximately US\$ 48 to \$130) for a pre-determined time period (approximately twelve to eighteen months). The Government plans to create PMGs comprising a total of 1,000 civil servants in 2003. PMGs are intended as an interim measure to allow the Government to make progress in strategic areas of service delivery in the short term while more long term solutions are developed. It is clear that PMGs will not, nor are they intended, to resolve the problem of low remuneration. Rather, they are intended to facilitate implementation of a select number of key reform initiatives, and this is the standard against which they should be evaluated. The intention of the PMG approach is to substitute for the ad hoc arrangements employed by donors to supplement salaries (often in violation of donors’ own policies and procedures). The basic concern that arises, given both scarce financial and administrative resources, is whether the PMG program will yield positive net benefits. The answer depends on the total cost to Government and donors as well as the administrative improvements yielded by the program. Moreover, given scarce capacity, it may be a challenge to implement the program. The Government should evaluate the program in late 2004 to determine whether further resources should be directed to PMGs or to other high priority reforms.

⁷⁶ To be clear, comparisons of international data such as these should be used only to probe findings developed in the context of country-specific analytical work, not to suggest specific policy reforms.

⁷⁷ Actual expenditures for years 1999-2001, budgeted for 2002.

from the low revenues/low wage bill equilibrium to a high revenues/higher wage bill equilibrium will require substantial improvements in tax and customs administration (see Chapter 1).

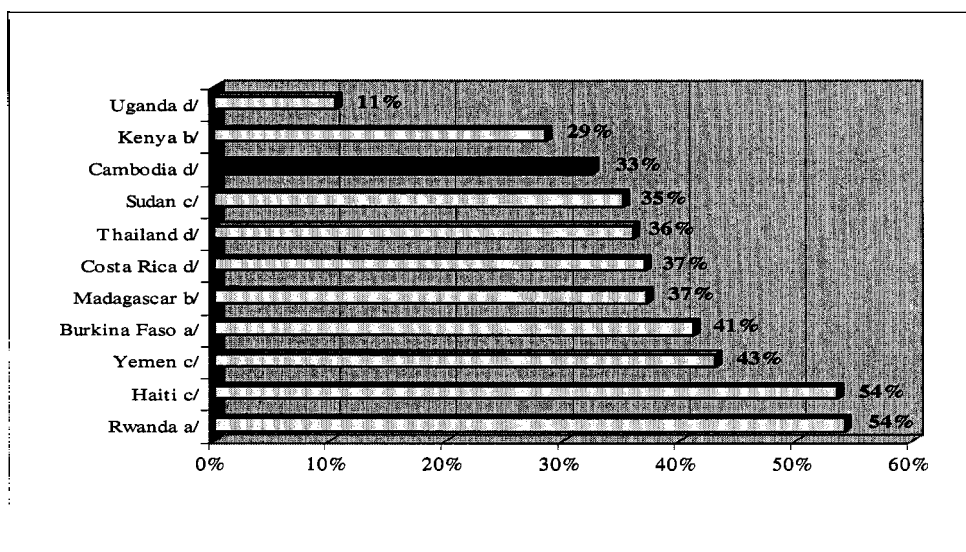
Figure 5.1: Total Central Government Wage Bill as a Percentage of Current Expenditures: Low and Middle Income Countries



Source: IMF Government Finance Statistics, SIMA Database, Cambodian budget data.

Years: a/ 1993, b/ 2000, c/ 1999, d/ 2001, e/ 1992, f/ 1996, g/ 1995.

Figure 5.2: Wage Bill as a Share of Total Revenues, Low and Lower Middle Income Countries^{e/}



Source: IMF Government Finance Statistics, SIMA Database, Cambodia (Budget Law, TOFE, and IMF staff estimates).

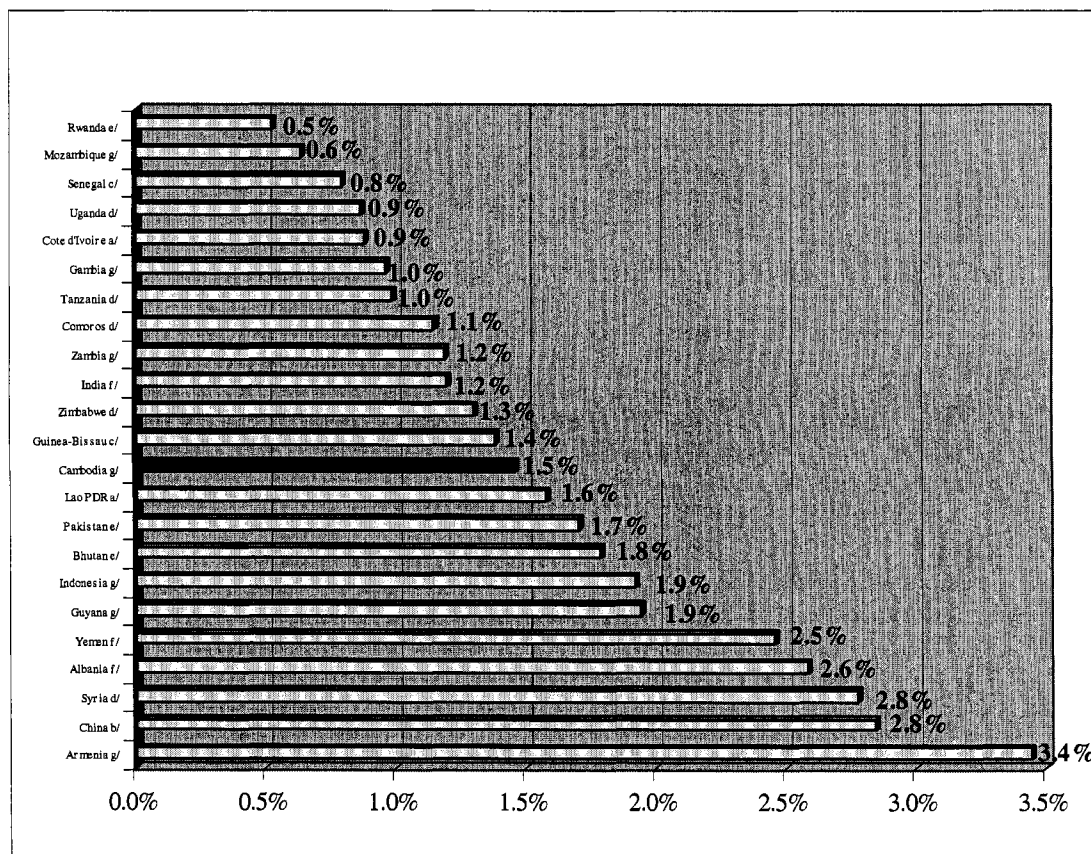
Years: a/ 1992-1993, b/ 1995-1996, c/ 1999-2000, d/ 2001.

^{e/} Includes tax and non-tax revenues, as well as grants.

5.8 With respect to the share of civil service employment to the total population, Cambodia, at 1.4 percent in 2001, falls just below the low income country average of 1.6

percent (see Figure 5.3). This simple comparison suggests that Cambodia's is not a bloated civil service. But neither is it one of the leaner in the developing world.⁷⁸

Figure 5.3: Civil Service Employment as a Share of Population: Low Income Countries



Source: Cross-National Data on Employment and Wages, World Bank, 2002; Cambodia Budget Law 2001.

Years: a/ 1993, b/ 1994, c/ 1995, d/ 1996, e/ 1997, f/ 1998.

Note: The figure for Cambodia is based on the latest available population figures. An estimate of 1.2% can be derived by using United Nations population projections for 2003.

5.9 A closer look at staff allocation to the priority sectors—health and education—also shows that Cambodia falls below the low income country averages. Cambodia's education and health sector public employment account for 0.7 and 0.2 percent of the population, respectively, while the low income group averages (1996-2000) are 0.9 and 0.6 percent, respectively. The comparison suggests that Cambodia has room to increase employment in these sectors, though, given the average size and cost of the civil service, also suggests that net reallocations would have to be financed by reductions in the non-priority sectors

5.10 This comparative analysis suggests that: (a) Cambodia's civil service is average in terms of cost and size; (b) Cambodia, which collects a relatively low amount of revenues, spends a relatively low amount on wages; and (c) the total size of the workforce is average, but the priority sectors (education and health) are under-staffed. The question is: Given poverty levels, severe budgetary constraints, and extremely low wages, can Cambodia afford to

⁷⁸ Interestingly, as a percentage of the total civil administration wage bill, Cambodia spends a significant amount on contractual workers (over 3 percent in 2002). The amount paid to contractual workers (including "floating" personnel) in 2002 would finance 6,053 civil servants (approximately 3.7 percent of total civil servants) at the prevailing average wage rate.

be average? The answer is “no.” The chapter takes up this challenging question by analyzing current civil service pay levels, civil service size and distribution, and the human resource management system. Finally, the chapter suggests a number of options for moving forward with pay and employment reform, but notes that these must be taken up as parts of a whole in order to make far-reaching progress a reality. CAR now has support to examine these reform options in greater detail as part of a comprehensive program of analytic work.

IMPROVING CIVIL SERVICE PAY: CURRENT PAY LEVELS AND EVIDENCE OF INADEQUACY

*“Government, donors and NGOs all acknowledge that low wages and low skill levels are contributing to the low morale and poor performance of the public sector. The NGO community reiterates that inadequate government salaries remain one of the major obstacles to the delivery of quality public services that could dramatically reduce poverty. NGOs working in Cambodia are particularly disillusioned by the lack of progress in this area, and especially the ones working in the health, education, legal and judicial sectors.”*⁷⁹

5.11 The most pressing issue facing the Cambodian civil service is undoubtedly the low level of pay for most civil servants, in relation not only to wage levels outside the service, but also to the cost of living. Indeed, it is widely acknowledged that civil service pay, which averaged approximately US\$ 33 per month in 2002 after a considerable increase, is inadequate.⁸⁰ Comparing the average wage to per capita GDP finds that a Cambodian civil servant only makes slightly more than the annual per capita GDP. Cambodia’s ratio of the average civil service wage to per capita GDP is one of the lowest in the region. The NGO Forum, for example, has cited low salary levels as one of the “major obstacles” to the delivery of poverty-reducing services. Moreover, public officials themselves view low salaries as the most important cause of corruption (World Bank, 2000, p. 27). For many reasons low levels of public sector remuneration require urgent attention.

5.12 With the exception of a very limited number of high level staff, most civil servants earn very little, in either absolute or relative terms (Table 5.1).⁸¹ Moreover, the compression ratios (the ratio of average pay of each category to the lowest category) are very low by international standards. The problem is compounded by the fact that functional allowances have been set at their lowest level as the “experience and efficiency” criteria have not yet been developed by CAR. Implementing regulations should be developed as soon as possible to allow for use of the higher level allowances. A compression ratio of under two will not be sufficient to attract the necessary quantity of highly qualified candidates to civil service positions. If the Government cannot attract qualified, experienced high and mid-level managers and professionals to spearhead program design and implementation, the RGC’s ability to deliver even basic services will be impaired. No doubt the Government’s ability to attract these professionals is constrained by distortionary salary supplementation practices among donors and NGOs (see paragraph 5.40). But the fact remains that decompression of salaries must become a basic element of the

⁷⁹ NGO Forum on Cambodia, “A Rapid Comparison of the NGO Statement to the 2002 CG Meeting and the Second Draft of the PRSP in Cambodia,” November 2002, p.8.

⁸⁰ The salaries of judges and prosecutors were also increased in 2002.

⁸¹ Approximately 700 officials received the special “AA” allowance, which is based on rank. The special allowance, which pertains to five functions (directors of department, vice governors of province/city, departmental inspectors, deans, and governors of districts), substantially increases total remuneration by the equivalent of between US\$ 130 and US\$ 205 per month. The Government’s aim in offering the AA allowance has been to begin to decompress the remuneration structure by increasing rewards to high-level administrative officials. However, one problem encountered has been somewhat unclear criteria for deciding to whom to grant the “AA” allowance. In practice it appears that some “acting” officials, who do not normally hold the particular post full time, have been given the allowance. This problem stems in part from the lack of an effective establishment control mechanism that maps individuals to approved posts.

Government's reform program. The precise content of the decompression plan should be determined after further study, but it is clear that significant decompression needs to take place.

Table 5.1: Median Monthly Remuneration, 2002

(US\$)			
Category	Level of Education	US\$/month	Compression Ratio
A	Secondary school + 4 years	40	1.9
B	Secondary school + 2 years	32	1.5
C	Secondary school	26	1.2
D	Other	21	1.0

Source: CAR

Note: Compression ratios for each category reflect the mean salary in that category as compared with the mean salary of Category D civil servants.⁸²

5.13 **The Government's Strategy to Rationalize the Civil Service (SRCS) is based on a medium term wage bill framework (MTWF) for the period 2002-2006.**⁸³ The MTWF would allow the average civil service wage to be increased from US\$ 28 in 2002 to US\$ 51.5 in 2006.⁸⁴ The end result – though not the ultimate objective – of the existing MTWF is to increase the average civil service wage to that of the current minimum wage in the garment industry. However, the average wage in the garment industry, as in other parts of the private sector, is much higher than the minimum wage. Table 5.2 shows that average wages data across the private sector are much higher than the average civil service wage. For example, a hotel manager would earn about 60 percent more than a senior public sector manager. Comparisons in the same sector also show the low absolute level of wages. Anecdotal evidence suggests that English as a second language teachers earn about US\$ 12-15 per hour, as compared to US\$ 0.25 per hour for a public school teacher (assuming an average wage of US\$ 40 per month and a 40 hour workweek).

Table 5.2: Private Sector Monthly Wage Data, 1999

	CR ('000)	US\$
Cigarettes	318.2	81.6
Textiles	332.7	85.3
Hotels	248.6	63.7
Construction	267.7	68.6
Memo item:		
Exchange Rate	3,900	

Source: Cited in Abrahart (2000).

5.14 **Evidence from the line ministries also confirms that civil service remuneration is much too low** (see Box 5.1 for evidence on approximations of market rates in the health sector). At the ministry level several different mechanisms are used to increase de facto remuneration. The problem is that though these mechanisms respond to an urgent problem, they may do so in an ad hoc way that creates distortions in the system. For example, MOH allows health establishments to allocate 49 percent of user charges collected to staff remuneration, which, however, results in wide regional differentials in civil service pay. Moreover, given that user

⁸² This follows the OECD approach of comparing means rather than extremes, which ensures that a handful of salaries will not dramatically skew the ratio. All compression ratio approaches can be misleading if there are significant monetary allowances not captured in the calculations.

⁸³ CARS, "Civil Service Rationalization Strategy: Medium Term Wage Projection, 2002-2006," 27 June 2002. It should be noted that the macroeconomic framework has since been revised.

⁸⁴ The MTWF estimates the average monthly wage at US\$ 28 in 2002, though actual expenditures put the average closer to US\$ 33 (TOFE report, April 2003).

charge revenues are much higher in referral hospitals as compared to district health centers, the MOH scheme further biases incentives in favor of working in urban as opposed to rural areas (and biases service delivery toward curative as opposed to preventive services). MOH also uses per diems allowed through the PAP system to increase pay. In 2002 MAFF used PAP to finance staff remuneration for its forest replanting program. MOEYS has created a special program in PAP ("PAP 1: Education service efficiency," budgeted at CR 11,200 million, or approximately US\$ 2.8 million in 2002) to finance redeployment of staff and increased remuneration, including financial incentives to teach in remote and difficult areas and for management/leadership functions. Another PAP program (2) finances additional pay for remedial instruction (allowances for double-shift and multi-grade teaching continue to be paid out of Chapter 10). These examples make clear the desperation at the line ministry level.⁸⁵

Box 5.1: Tripling or Quadrupling? A Health Sector "Experiment" Shows that Public Sector Wages Need to be Increased by Multiples of Current Levels

The Ministry of Health has engaged in several innovative experiences with contracting-in and -out, as well as other pilot reforms, of health service delivery. In a number of different provinces the management of district health centers has been turned over to third parties, mostly NGOs, operating under a number of managerial arrangements. Under the contracting-in arrangement the contractor receives funds to provide technical support to the operational district (OD), has management responsibility for the OD, but has limited administrative authority over MOH staff. While personnel and O&M costs for the OD remain the responsibility of the ministry, the contractor receives an annual supplement of US\$ 0.25 per capita, over which he has complete control. Under the contracting-out arrangement the contractors were given full responsibility, including over the budget and staff, for the OD (staff became directly employed by the contractor). Included in this set of pilot projects were a number of control districts; ODs were randomly assigned to the contracting in, contracting out, and control groups. A subsequent study found that the ODs operating under the contracting-out arrangements registered rapid increases in the quantity of services provided to clients as compared with the contracting-in and control ODs.

Not surprisingly, one of the measures that most of the contractors instituted was salary reform. The data show the range of salaries paid by contractors (CO and CI) to their public health staffs (in US\$, monthly average): Pereang (70-180), Ang Roka (77-160), Memot (80-200), Cheung Prey (40-100), and Kirivong (40-80).

Taking the average monthly wage as US\$ 28 (May 2002), it is apparent that contractors felt they needed to pay multiples, ranging from about 1.5 in the lowest cases to 7 in the highest, of that wage in order to attain results. *The average of the midpoints of these ranges is US\$ 102, indicating a multiple of over 3.5 with respect to the average public sector wage.* According to a Medicam report, "The provision of incentives by the NGO has been an approach applied by all NGOs. The NGOs consider this as the most important necessary condition for effectively running district health services (p. 20)."

Source: "Contracting and Similar Experiences in Health in Cambodia," Pieter Feenstra/Medicam, December 2001.

5.15 To resolve the demand issue the Government has committed to undertaking a labor market survey to determine the remuneration needed to be offered by the Government to provide the incentives needed to recruit and retain well-qualified staff. The labor market analysis should include a comparator pay survey, attitudinal surveys among staff and potential recruits, and studies of private sector as well as NGO markets. The results of the analytical work, and the Government's subsequent policy, will likely focus on targeting pay increases to specific cohorts of civil servants in high priority areas, as well as to higher level management. Thus, labor market information is urgently required as an input to a revised MTWF.

⁸⁵ Average monthly salaries at the NAA are also reported to be much higher (around US\$ 170).

Recommendations

- Decompress civil service salaries starting with high level managers (Category A). The precise content of the decompression plan should be determined in conjunction with other variables and after further study.
- Increase civil service remuneration significantly in the short to medium term. The pay strategy should be based on the forthcoming survey of labor market conditions.

RATIONALIZING CIVIL SERVICE EMPLOYMENT: THE CURRENT SIZE AND DISTRIBUTION OF THE CIVIL SERVICE

5.16 Both the size and allocation of the civil service act as constraints on efficient service delivery. On the one hand, the size of the civil service has been increasing, though unevenly, since the mid-1990s. On the other hand there is some evidence that the deployment of civil servants is problematic from the perspective of delivery of high priority poverty-reducing services. Large shares of civil servants are deployed in low priority sectors and in some sectors inadequate numbers of civil servants are deployed in the provinces. Moreover, only a small number of civil servants are women. Rationalizing civil service employment could increase resources for the priority sectors and promote greater efficiency in personnel management.

5.17 The size of the civil service has been increasing since the mid-1990s, though data sources are inconsistent. CAR's census of the civil service recorded a total of 163,000 employees in 2001. According to the 2003 budget law, the size of the civil service now stands at 166,872 (this figure does not include ministers and other political appointees, which number 906 in 2003). According to the budget laws, the size of the civil service appears to have increased significantly since 1994, from 148,353 to 167,778, representing an increase of 13 percent. Rather than an actual increase in hiring, however, the increase of 6.6 percent in 2000 seems to correspond to a readjustment of the figures after an extension of the retirement age from 55 to 60. The explanation for the increase of 2.2 percent in 2003 is unclear, though it is possible that some of the increase could be due to the requirement to post clerks to each of the newly elected commune councils.

5.18 The fact that the RGC does not use one set of official numbers when counting its civil servants creates confusion and undermines robust analysis. With the completion of the census, the budget law data should have been based on CAR's data. It is unclear why this has not happened, though it seems that CAR's database has not been utilized outside of CAR. Granting wider governmental access to the database would improve the quality of policy analysis and is necessary to ensure transparency. The accomplishments of the civil service census have been somewhat obscured by the lack of available data. For example, though it has been reported that the recent census and the automation of the payroll led to the removal of over 9,000 ghost workers, this reduction is not apparent either in the budget law or the CAR figures, nor is it visible in the difference between the two sets of figures (see Table 5.3).⁸⁶ Greater transparency is necessary both for showcasing the Government's accomplishments and for improving the management of the workforce. It is imperative for the Government to use a single, unified database, and for MEF to have complete access to CAR's database for budget preparation purposes, and for the line ministries to have ("read only") access to the database for personnel and budget management purposes.

5.19 As indicated by CAR's projections for 2003-2006 the size of the civil service is programmed to decrease slightly. The SRCS calls for the recruitment of approximately 22,875 new civil servants (20,075 in the education sector), attrition of 9,025, and departure (contracting

⁸⁶ CARS has committed to providing this data, however it has not yet been made available.

out, privatization, and voluntary departure) of 15,750 (12,550 in the non-education sectors) over the period 2003-2006. However, it is unclear how the increase in staffing in 2003 will affect CAR's medium term scenario. The SRCS scenario will have to be updated to reflect the actual staffing situation. The apparent lack of coordination between CAR and MEF, as well as other line ministries, undermines attempts to plan over the medium term (see section on MTEF below), though efforts to improve coordination are underway.

Table 5.3: Historical Size of the Civil Service by Source ^{a/ b/}

	Budget Law	CAR
1994	148,353	n/a
1995	143,855	n/a
1996	147,086	n/a
1997	153,372	n/a
1998	156,731	161,466
1999	155,233	162,772
2000	165,539	162,991
2001	164,397	162,969
2002	164,219	165,369
2003	167,778	166,381
2004	n/a	165,953
2005	n/a	164,595
2006	n/a	163,469

^{a/} 2004-2006 figures based on CAR projections.

^{b/} Budget law data include political appointees and contract and floating staff, while CAR data do not.

Distribution of civil servants by category, function, region, gender, and age

5.20 There is not a single, updated published source of information on the Cambodian civil service. Information must be pieced together from the budget laws, CAR database, and old State Secretary of the Civil Service (SSCS) reports. Information on grade, function/ministry, and center/province is available in the budget law. Additional information is sometimes available from CAR on an ad hoc basis. The quality of the SSCS 2000 report is impressive, and the RGC should take steps to re-introduce it on a priority basis with updated information from the CAR database. This would require greater coordination between CAR and the SSCS, as well as increased capacity within CAR.

5.21 The majority of civil servants (40 percent) pertain to category C, which is reserved for those with a secondary education (see Table 5.4). Nearly two-thirds of the civil service have a secondary educational level or lower. Only 11 percent of civil servants have completed college, though some 24 percent have some university training. The low educational level of the civil service, a legacy of recent Cambodian history, places a serious constraint on the quality of government performance broadly and on the delivery of essential services in particular. This capacity issue can only be resolved over the long term.

Table 5.4: Civil Service Numbers, 2003

Category	Education	Non-Education	Total	%
A	6,747	12,061	18,808	11%
B	21,713	18,203	39,916	24%
C	51,601	15,961	67,562	40%
D	4,395	27,324	31,719	19%
Other a/	606	8,261	8,867	5%
Total	85,062	81,810	166,872	100%

Source: 2003 Budget Law.⁸⁷

a/ Includes personnel on term contracts, "floating," and on leave without pay.

5.22 Just over half of total state employees serve in core (central) government functions, and of these, the vast majority work in defense and public order.⁸⁸ Social development, at 39 percent in 2003, accounts for the second highest share of employees and six ministries, while economic services account for only 9 percent of government staff, though it encompasses ten ministries. At first glance, given the need to increase the share of civil servants working in social services (see below), and given the already low share of civil servants in economic sector services (viz., road transport and agriculture), any reduction and/or reallocation would appear to have to come from the core government function. This hypothesis will be probed further in the functional analysis study to be undertaken by the RGC.

5.23 The education sector commands by far the largest share of civil servants (that is, excluding defense and security). In 2003 education is programmed to account for just over half of all civil servants. By CAR's estimates the share to education will have to increase to 61 percent by 2006 to meet the sector's needs. Given a very slight decrease in primary school enrolment from 2003-2005 and a large estimated increase in secondary school enrolment, from about 740,000 in 2003 to over 1,100,000 in 2005, and given pupil-teacher ratio objectives of 45 at the primary and 30 at the secondary levels in 2005, further increases in the sector are required. MOEYS estimates the need for a total of 109,000 teachers and staff by 2005. Holding the total number of civil servants constant at CAR's programmed figure of 163,469, the sector would account for nearly 67 percent of the total. The reallocation toward education will thus require further reduction in the size of the non-education workforce.

5.24 The vast majority of civil servants, approximately 79 percent, are based in the provinces. MOEYS and the MOH account for 62 percent and 11 percent, respectively, of these provincial staff. The Ministry of Interior accounts for the next largest share, at 7 percent, while MAFF accounts for 4 percent. Of the central ministry-based staff in Phnom Penh, MEF, at 12 percent, accounts for the largest share, followed by MOH at just under 12 percent and MAFF at 11 percent. The Council of Ministers accounts for 6 percent while the Ministry of Culture and Art accounts for 5 percent of the total. See Annex A Table 5.4 for a breakdown by ministry and location.

5.25 These aggregate data, however, mask some of the problems surrounding the geographic distribution of civil servants. Anecdotal evidence indicates that low pay and the absence of "moonlighting" opportunities in the provinces mean that civil servants prefer to work in Phnom Penh and the provincial capitals. The result is an oversupply of civil servants in urban areas and inadequate service delivery in the provinces, where most Cambodians live. The problem is more acute for the higher professional civil servants, which results in a skewed distribution of skills and has a negative impact on the quality of service delivery. MOH, for

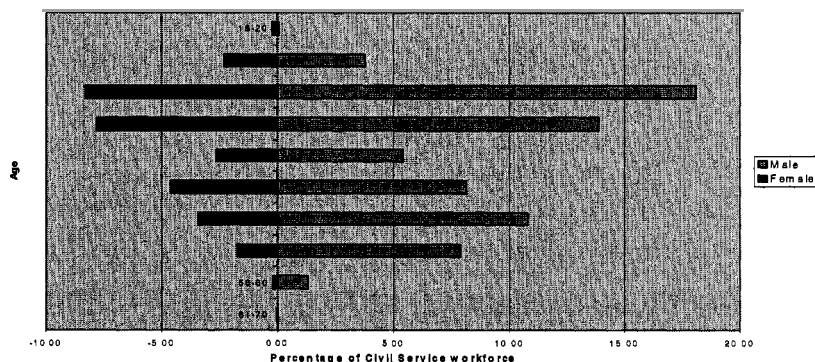
⁸⁷ It is unclear whether these data match those in the HRMIS.

⁸⁸ Data include defense forces, but not police, for which data were unavailable.

example, reports difficulties in maintaining its presence of doctors evenly across the provinces, which has resulted in differentials in the doctor-patient ratio by province, and MOEYS has serious problems attracting teachers to rural areas. The surplus staff in the urban areas tend to work in administrative rather than operational positions, further reducing their usefulness. In the education sector, for example, though about 20 percent of the total staff are in non-teaching positions, which is not high, MOEYS suffers from a high proportion of administrative staff at the level of secondary education. In primary education, the teaching: non-teaching staff ratio averages 7:1, compared with a very low 2.5:1 in secondary education, where clearly efficiency gains are possible. This is even more unfortunate in the context of an overall shortage of teachers. At the same time, a number of ministries have large percentages of their workforces based in the capital, when, given the nature of their work, one would expect the preponderant share of staff to be located in the provinces: MOWRAM (55 percent), Ministry of Environment (56 percent), Ministry of Post and Telecommunication (65 percent), and MAFF (41 percent, where the situation is even worse at district than at provincial level, for example in terms of agricultural engineers and agronomists). It is impossible to say, a priori, whether these staff allocations make sense, but these figures confirm the need for a functional analysis to improve the efficiency and effectiveness of these scarce resources.

5.26 Gender distribution of the civil service is also uneven, with a nearly 70 percent male workforce and the majority of female staff aged between 18 and 35 (Figure 5.4). The Government has committed, as part of the Millennium Development Goals (MDG), to increase the percentage of women in decision-making positions within the government. Targets for 2008 have been set at 12.5% for women with the rank of Minister, 17% for Secretaries of State and 16.7% for Under Secretaries of State (the corresponding figures for 2003 are 8.7%, 8%, and 8%, respectively).⁸⁹ To address this concern, MOWVA has suggested that an affirmative action policy for women may be necessary. It is recognized that, at least in part, the problem stems from the fact that many fewer girls and young women complete secondary school and university, as compared to their male counterparts, making capacity building an attractive option for redressing inequality. However, it has also been suggested that deep-seated prejudices about the nature of appropriate work for women and concern about women's roles in society also have an important influence. A study of obstacles to greater gender equity in the civil service should be conducted to provide the necessary analytical underpinnings for moving forward with policies that promote greater gender equity.

Figure 5.4: Age and Gender Distribution of the Civil Service in 2000



Source: State Secretary of the Civil Service

⁸⁹ Targets agreed June 2003 by MOWVA.

5.27 This section on employment and deployment suggests that: (a) reallocation of human resources to the priority sectors is necessary, given the Government's commitment to poverty reduction; (b) some compensated departure is in order both in the non-priority sectors and of lesser skilled workers; and (c) redeployment from center to province is necessary in some sectors. Additional options such as contracting in, contracting out and autonomization should be considered through a study of alternative service delivery (ASD) mechanisms begun in mid-2003. A functional analysis/operational review would be necessary to ascertain what the overall level of employment ought to be, where exactly the sectoral inefficiencies are, and what composition of public sector employment makes the most sense for Cambodia. The Government has agreed to undertake a functional review,⁹⁰ which should be sure to cover the appropriate institutional arrangements, organization, processes, and staffing of government functions in order to improve efficiency and effectiveness in service delivery.

Recommendations

- Develop fully an employment strategy to (1) redeploy civil servants to the priority sectors, from central to provincial offices, and from staff to line functions; and (2) provide for compensated departure in the non-priority sectors and of lesser skilled workers. This strategy should be based on a functional review that covers the appropriate institutional arrangements, organization, processes, and staffing of government functions (based on analytical work to be carried out in mid-2003).
- Develop a unified, consistent human resource database, linked to the budget formulation process.
- Re-introduce the SSCS civil service annual report on a priority basis with updated information from the CAR.
- Conduct a study of factors, such as education levels, social mores, and actual civil service practices in selecting and promoting women to provide the necessary analytical underpinnings for moving forward with policies that promote greater gender equity in the civil service.

PAY LEVELS AND THE MEDIUM TERM WAGE FRAMEWORK

5.28 The previous two sections make the case that civil service remuneration needs to be increased and decompressed, and that employment needs to be rationalized by reallocation and compensated retrenchment. The purpose of this section is to elucidate possible routes to comprehensive pay and employment reform. The section suggests that strategies will have to include increased resources for civil service wages in both absolute terms (that is, by increasing the total amount of resources available for recurrent expenditures) and in relative terms (that is, by reallocating resources from other uses to fund a higher civil service wage bill and by reducing the size of the civil service), given resource constraints. The section also argues that Government will also have to marshal additional resources from donors to fund an increase in the wage bill. The simulations conducted in this section are meant to be illustrative and not to suggest specific policy targets.

5.29 In the recent past the Government has attempted to contain the total wage bill to be less than 40 percent of current spending, as recommended by the IMF. The total wage bill (Chapter 10) has declined steadily since 1998 as a percentage of recurrent expenditures, both in terms of the budget laws and actual execution, even as actual expenditures in riel have risen (in nominal terms) from 1998-2001 (see Table 5.5). This is due in part to the combination of a ceiling on the wage bill with an increase in O&M spending in the priority sectors. The defense

⁹⁰ CARS, "Operational Review of Service Delivery," October 2002

security (DS) wage bill, after increasing by nearly 12 percent from 1998-1999, has declined steadily from 1999 to 2002, with the largest decrease coming in 2001-2002 (budget law). Thus by 2002 the DS wage bill is programmed to be lower than in 1998. On the other hand the civil administration (CA) wage bill has steadily increased over the period 1998-2002 both in programmed and actual expenditures. In relative terms the share of the DS wage bill has declined from 66 percent in 1998 to 48 percent in 2002, while the CA share has increased from 34 to 52 over the same period, which is indeed a very positive development on the functional resource allocation front. It is also worth noting that in terms of execution rates the CA wage bill has either matched or exceeded the DS wage bill, though overall wage bill execution rates have been deteriorating over the past few years.

Table 5.5: The Wage Bill, including Civil Administration and Defense/Security, as a Percentage of Recurrent Expenditures, Budgeted and Actual, 1998-2002

	1998	1999	2000	2001	2002
(CR millions)					
Civil administration wage bill (budget law)	144,730	171,014	218,115	235,285	258,625
Defense/security wage bill (budget law)	282,140	315,000	309,250	307,000	265,350
Total wage bill (budget law)	426,870	486,014	527,365	542,285	523,975
Total wage bill (actual expenditures)	447,541	518,034	517,208	509,086	544,389
Total wage bill (budget law) as pct. Of recurrent expenditures	48%	44%	40%	38%	33%
Total wage bill (actual) as pct. of recurrent expenditures	48%	47%	43%	36%	41%
Civil administration wage bill as pct. of total wage bill (actual)	34%	37%	41%	44%	52%
Defense/security wage bill as pct. of total wage bill (actual)	66%	63%	59%	56%	48%
Civil administration wage bill: execution rate	106%	112%	98%	95%	109%
Defense/security wage bill: execution rate	104%	104%	98%	93%	99%
Overall wage bill: execution rate	105%	107%	98%	94%	104%

Source: Budget laws and TOFE.

5.30 While the 40 percent constraint was met in 2000 in the budget law, it was not met in practice, as actual expenditures reached 43 percent of total recurrent spending. Nonetheless, in 2001 and 2002 the programmed wage bill was set to decline to 38 and 33 percent, respectively (the actual wage bill was 36 percent of current spending in 2001). Given the wage increase effected in 2002 due to the introduction of a new classification system, however, the wage bill is expected to be higher than that programmed in the 2002 budget (it appears that the fiscal impact of the new classification system was not fully factored into the 2002 budget law). The latest available data for 2002 (April 2003 TOFE) show the actual CA wage bill as 118 percent of the budget, and 37 percent of current expenditures.

5.31 Taking into account the existing macroeconomic framework, Table 5.6 provides an estimate of the MTWF for the period 2003-2007.⁹¹ Based on most recent (December 2002) projections available (for GDP, the ratio of tax collections to GDP, and the ratio of current spending to GDP), the total civil administration wage bill is estimated as a function of three key variables: (a) change in tax collections, (b) change in the wage bill ceiling as a percentage of current spending, and (c) the functional composition of wage bill spending (CA and DS). In the base case, assuming that there are no additional increases in tax collections (above those already projected), assuming Government allocates a full 40 percent of current spending to the total wage

⁹¹ This MTWF, referred to throughout the rest of the chapter, is based on the most recent IMF estimates and presents the total CA wage bill envelope for the period. For these reasons there are differences with CAR's MTWF referred to earlier.

bill, and assuming that the DS share of the total wage bill remains at 51 percent over the period, the resource envelope for the CA wage bill is expected to grow by 65 percent from CR 349,706 in 2003 to CR 575,309 in 2007 (in millions of nominal riel). The base case thus permits a significant increase in the CA wage bill based on sustained GDP growth and substantial increases in tax collections.

Table 5.6: Cambodia: Medium Term Wage Bill Framework, 2002-2007^{a/}

	2002	2003	2004	2005	2006	2007
	Projections					
Under current assumptions						
Wage bill ceiling: 40% of current expenditure (CR million)	638,339	713,686	813,165	910,408	1,029,480	1,174,101
Wage bill ceiling: 40% of current expenditure (US\$ million)	162,637	177,414	195,676	212,646	233,454	258,495
Current Expenditures (CR millions)	1,595,847	1,784,214	2,032,913	2,276,020	2,573,701	2,935,252
<i>Revised assumptions (variables in bold)</i>						
Revenues as a percentage of GDP	12.1%	12.7%	13.4%	13.9%	14.3%	14.5%
Additional growth in revenue collections as percentage of GDP (percentage points)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Revenues as a percentage of GDP (revised) ^{b/}	12.1%	12.7%	13.4%	13.9%	14.3%	14.5%
Current expenditures as a percentage of GDP	11.1%	11.4%	11.9%	12.2%	12.6%	13.1%
Current expenditures as a percentage of GDP (revised)	-	11.4%	11.9%	12.2%	12.6%	13.1%
A. Revised current expenditures (CR millions)	-	1,784,214	2,032,913	2,276,020	2,573,701	2,935,252
Wage bill ceiling as percentage of recurrent expenditures	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
B. Revised total wage bill ceiling (CR millions)	-	713,686	813,165	910,408	1,029,480	1,174,101
Defense/security as percentage of wage bill	51%	51%	51%	51%	51%	51%
Annual decrease (cumulative, percentage points)	0%	0%	0%	0%	0%	0%
C. Revised civil administration wage bill ceiling (CR millions)	-	349,706	398,451	446,100	504,445	575,309

Source: IMF projections and World Bank staff estimates.

^{a/} Neither Priority Mission Group costs nor any voluntary departure costs have been included in the framework owing to the lack of detailed cost estimates, including the possible contribution of donor funding.

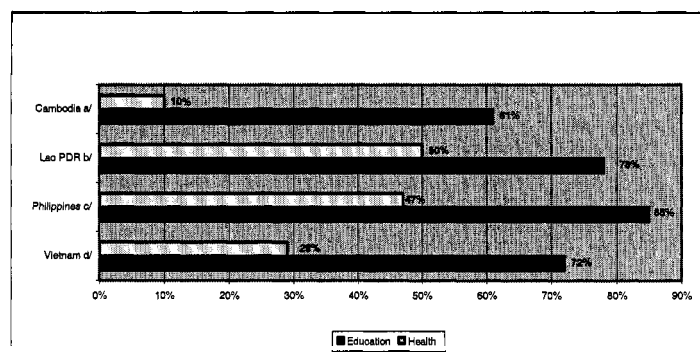
^{b/} Assumes that all additional revenues are spent on recurrent expenditures.

5.32 A reallocation of resource to the civil administration wage bill is one of the central issues for the Government's medium term expenditure framework, yet the proposed MTEF has yet to incorporate any strategic objectives on the economic composition of expenditures. The MTEF does propose a strategic reallocation to the priority sectors: "The strategic reallocation of resources toward the priority sectors—especially education and health—and away from defense and internal security is one of the objectives of the proposed MTEF."⁹² Yet the MTEF neither analyzes nor programs the economic classification of spending in terms of wage and non-wage for the period. The problem is that with large programmed compositional shifts to the priority sectors, especially health and education (from 8.4 percent of current spending in 2000 to 12.9 in 2005, and 14 percent in 2000 to 20 percent in 2005, respectively), the total envelope for recurrent spending has been increasing, while the wage bill has not nearly increased as much. The result is a declining share of the wage bill as a percentage of total recurrent spending. Moreover,

⁹² "Medium Term Expenditure Framework, 2003-2005" draft document, 12 September 2002, p.1.

the MTEF must be explicit about the source of financing for the wage reforms, including the Strategy to Rationalize the Civil Service (SRCS).

Figure 5.5: Cross-Country Comparisons of Personnel Expenditures as a Percentage of Recurrent Spending in Education and Health



Years: a/ 2001, b/ 1997, 1998-99, c/ 1997, d/ 1997, 1998.

Source: Budget data (Cambodia), UNESCO, SIMA Database, World Bank PERs.

5.33 The share of personnel expenditures in total recurrent spending on education and health is significantly lower in Cambodia than in other East Asian countries. Table 5.7 shows that the MOEYS wage bill as a percentage of recurrent spending is slated to decline from 75 percent in 1999 to 57 percent in 2005 (the trend is thus accentuated by the MTEF), while the MOH wage bill has actually fallen by more than half from 1998 to 2001 as a percentage of recurrent spending. It is possible that the economic composition of spending in the priority sectors has become inefficient, as it is clear that the composition is driven from the top down rather than from the bottom up. The preliminary expenditure data for 2002 show a welcome reversal of this trend, but the data are likely to change further as non-wage expenditures are posted over the next couple of months. Further steps need to be taken to improve the efficiency of non-wage recurrent spending and correct the imbalance in the economic composition of spending, especially in the priority sectors. The Government plans to revise the MTEF, along with CAR's MTWF, and in doing so it should allow for substantial increases in the civil administration wage bill. Increasing civil service wages in these sectors is the obvious solution, and one short-term option is to use targeted functional allowances to boost priority sector wages. This remedy would need to be undertaken in the context of a systematic pay and grading restructuring to provide sustainable pay relief, however.

Table 5.7: Personnel Expenditures as a Percentage of Recurrent Spending, 1998-2005, in Education, Health, and Agriculture

	1998	1999	2000	2001	2002	2003	2004	2005
MOEYS ^{a/}	n/a	75%	73%	61%	67%	54%	55%	57%
MOH ^{b/}	24%	16%	13%	10%	20%	n/a	n/a	n/a
MAFF ^{c/}	n/a	30%	27%	13%	28%	n/a	n/a	n/a

^{a/} 1999-2001 are actuals (TOFE), 2002 from TOFE (Feb. 2003), and 2003-2005 from MTEF. Remuneration from PAP is recategorized as personnel expenditure.

^{b/} 1998-2001 are actuals (TOFE) and 2002 from TOFE (Feb. 2003). No data available from MTEF.

^{c/} 1999-2001 are actuals (TOFE) and 2002 from TOFE (Feb. 2003). No data available from MTEF.

5.34 The challenge for the Government is to assess to what extent additional shifts in resource allocation could open up possibilities for further civil service wage increases. A preliminary analysis of the MTWF suggests that there are four key variables, or levers, that the Government could manipulate to increase public sector remuneration: (a) the tax effort, (b) the

ceiling on the total wage bill, (c) the share of the wage bill allocated to the civil administration, and (d) the overall size of the civil service. The details of the simulations are presented in Appendix 5A.

5.35 The simulations show that a combination of policies—namely, increasing the wage bill ceiling as a percentage of expenditures, reallocating from defense/security to civil administration, increasing tax revenues, and retrenching staff—can have a significant increase on average remuneration. For example, the projected average monthly wage in 2007 is nearly one-third higher in the alternative/improved scenario (US\$ 80 as compared to US\$ 61) and nearly two-thirds higher in the radical/optimistic scenario as compared to the base case (US\$ 100 as compared to US\$ 61). Moreover, if these gains were focused on the priority sectors through targeted allowances the impact would be even greater. These simple projections, which are intended as illustrative and not to prefigure any specific outcomes, show that, given the right policies, civil service remuneration can be increased from the Government's budget before resorting to international aid to fund pay reform.

5.36 There is no doubt that difficult decisions will have to be made by the Government over the medium term. But there is also no doubt that one of the most important binding constraints on improving the quality of poverty-reducing services is the low level of public sector remuneration. The benefits and costs of reallocations from non-wage recurrent spending to the wage bill, of a shift in the functional composition of the wage bill from defense/security to civil administration, and of retrenchment will have to be carefully weighed.

5.37 Making progress on pay reform, however, would likely attract support from a broad coalition of stakeholders, including donors as well as civil servants. For example, a recent survey found that public officials support retrenchment of civil servants if such a measure would permit “an increase in salary and benefits for remaining government workers” (World Bank, 2000:33). This finding runs counter to conventional wisdom by suggesting that the gravity of the low pay problem might make mobilization of support easier if it is clear that retrenchment would be linked to a significant pay increase. Many donors would also support comprehensive pay reform as a way to improve governance and as a pre-condition for the reduction of corruption, both of which would increase the effectiveness of external aid.

5.38 Even with a substantial reallocation of resources, however, it is unlikely that adequate wage levels are attainable. It is clear that additional donor resources will be required, though the precise amount would depend on the details of the remuneration reform. A very preliminary analysis carried out in 2001 estimated that the cost of a more competitive pay policy⁹³ would run approximately CR 507 billion per year (note that this estimate is based on a particular scenario and is presented for illustrative purposes, not to suggest specific policies). The key assumptions of the scenario were that average monthly salaries would be increased to US\$ 228 for senior management (estimated as about 75 percent of equivalent pay in the NGO sector), US\$ 70 in the education sector, and US\$ 50 in the non-education sectors. Taking into account the resource envelope from the MTWF, the external financing requirement for 2003-2005 would range from approximately US\$ 80 million in the base case to US\$ 24 million under the optimistic scenario. Table 5.8 provides details on the potential financing gap. As the table indicates, the gap will vary widely depending on the amount of domestic resources shifted to the CA wage bill. This analysis is meant to serve as an indication of the orders of magnitude of the cost of reform, rather than as the final word. Much more work is needed to work out the details both of the remuneration reform and the need for external financing.

⁹³ Bannock Consulting, “Developing strategies for Priority Mission Groups towards sustainable civil service reform,” November 2001.

5.39 **One potentially promising option is to approach external financing for civil service pay reform through budget support.** It has been suggested that by pooling donor resources currently used for project management unit (PMU) salary supplements and channeling them through the budget to support the wage bill, progress could be made toward meeting the reform-induced financing gap. The basic premise of this approach is that rationalization of salary supplementation, which is estimated to range from US\$ 6 to 10 million per annum, could form an important pillar of a major program of civil service wage reform that could be put in place on a "sunset" basis (i.e., declining as revenues and civil service management capacity build). If, for example, current salary supplementation totals US\$ 8 million per year, then the total additional financing requirement over a three year period (presented in Table 5.8) would range from US \$56 million in the base case to zero in the optimistic case. Pooling donor salary supplements as budget support for civil service reform would also eliminate the distortionary impact of such supplements in the Cambodian labor market and strengthen the public sector itself.

Table 5.8: Estimated External Financing Requirements under Wage Bill Scenarios, 2003-2006 ^{a/ b/}

(CR billions unless otherwise noted)

	2003	2004	2005	2006
Estimated cost of reform	507	507	507	507
Resources available c/				
Base case	350	398	446	504
Improved scenario	381	443	505	582
Optimistic scenario	420	497	577	676
External Financing Requirement				
Base case	157	109	61	3
Improved scenario	126	64	2	n/a
Optimistic scenario	87	10	n/a	n/a
Total financing requirement (US\$ millions)				
Base case	80.4			
Improved scenario	46.8			
Optimistic scenario	23.6			

Source: World Bank staff estimates.

^{a/} Remuneration reform scenario based on Bannock Consulting (2001).

^{b/} Retrenchment scenarios not included in these calculations.

5.40 **Much work would be needed to design and implement a pooled donor approach to remuneration reform through budget support.** A fully costed reform proposal would have to be developed, donors and NGOs would have to agree to rationalize their current salary supplementation practices, and the Government would have to hold extensive dialogue with donors on the budget support mechanism. In addition, international experience with pooled donor support for salary reform would have to be investigated.⁹⁴ The Government has agreed to carry out the analytical work necessary for fleshing out options for pay and employment reform using a pooled donor support mechanism and rationalizing salary supplementation practices. This work is a necessary pillar of any further reform and should be carried out as soon as possible.

⁹⁴ A recent example of such an approach is Bolivia, where multilateral and bilateral donors are financing a five-year salary enhancement scheme. Donor financing will support, on a declining basis, a portion of the incremental recurrent costs necessary to increase salaries for managerial and professional posts in priority ministries. See "Towards a Medium Term Pay Reform Strategy for the Mozambique Public Service," Theodore Valentine, October 2001.

Recommendations

- Develop a strategy to increase and decompress civil service remuneration by increasing the overall wage bill through greater tax collections, reallocating from lower- to higher-priority sectors, such as from the defense/security to the civil administration sector, redressing the imbalance in wage to non-wage spending, and retrenching civil servants in the lower priority sectors while providing compensation.
- Revise the MTEF to make sure it is consistent with CAR's MTWF.
- Use greater functional allowances to boost priority sector wages as a short term measure.
- Carry out the analytical work necessary to develop options for pay and employment reform using a pooled donor support mechanism and rationalizing salary supplementation practices (to be carried out in late 2003).

STRENGTHENING CIVIL SERVICE MANAGEMENT: SAFEGUARDING MANAGERIAL AND FIDUCIARY CONTROLS

5.41 The Government has made progress on several fronts in the area of personnel management. The most important reforms to date include the civil service census and the development of the Human Resource Management Information System (HRMIS), which has allowed for simplification and automation of the payroll, as well as facilitated the review of human resource management policies. Building on this progress, the RGC is well-placed to address short term priorities, such as strengthening establishment control, and medium term priorities, such as improving merit-based recruitment and promotion practices.

Payroll Management

5.42 It is clear that poor treasury management exacerbates the already serious problem of low wages by under-paying civil servants, and paying sporadically and unevenly during the year. The fact that the process of preparing and certifying the monthly civil service payroll list has been improved by reducing the steps from fourteen to six (at both the provincial and central levels). This new process should improve and hasten the process up to the point at which it is taken over by the Treasury.

5.43 The Government has also made substantial progress by introducing an automated payroll through its HRMIS. Each month, the HRMIS system produces a hard-copy pay bill for ministries and provinces. The pay bill lists each employee within the ministry or province, their unique staff number, their job designation, their section/unit, and certain other information relating to family dependents, including the amount of functional allowances (the system does not provide individual pay slips). The pay bill is then verified as accurate by the personnel section of the relevant ministry/province and it forms the basis for payment of salaries to staff. The relevant personnel official obtains Treasury approval for release of the appropriate funds, based on the pay bill, and the funds are then disbursed to staff, who sign to indicate that they have received the relevant amounts. There has thus been substantial progress toward the policy objective of "automating" pay, and, by extension, reducing corrupt and/or opaque payroll practices.

5.44 The calculation of individual monthly remuneration is somewhat complex, due to the nature of the classification system. Civil service wages are broadly divided in two types of payments: base salaries, which account for over 58 percent of total pay, and allowances, which include functional, pedagogical, family, and risk allowances. The first three types of allowance are the most significant in terms of proportion of the wage bill, representing respectively, 27 percent, 3 percent, and 3 percent in 2002. Once these pay and allowance factors have been determined it is possible to calculate pay by adding together the basic pay and all the allowances. The concern with the complexity of the system is that it acts as a tax on administrative capacity

both in the central oversight and line agencies. Even given the automated payroll, clerical staff must provide important support services to the overall system. A simpler system would consume fewer administrative resources and result in fewer potential errors and thus greater control. Though such a system might make more sense in the future when salaries are higher, at present there would be benefits to simplifying the system. A further drawback is that individual pay slips, which would make the system more transparent, are not produced by the automated payroll system (though a limited number of high ranking officials do receive pay slips). The Government should introduce individual pay slips, as resources permit, over the medium term.

5.45 Another factor that obfuscates actual remuneration is the use of overtime pay, which, at more than US\$ 6.9 million in 2002, is not an insignificant amount. Though data on use of overtime pay are not available by ministry or civil service category, some simple calculations demonstrate that it is a significant amount in relative terms (there is some indication that a significant share of overtime pay is allocated to teachers). Assuming that overtime pay was distributed equally across civil servants during the year would mean that the average monthly salary would have been US\$ 3.52 higher in 2002. At an average salary of US\$ 28 (programmed for 2002) before overtime, the additional compensation would represent an increase of over 12 percent. The regulations and procedures for authorizing overtime pay should be reviewed in light of the significant share of the annual wage bill allocated to overtime, especially in the absence of an establishment register and discrepancies in actual numbers of civil servants by official source.

Staff recruitment and promotion

5.46 Ideally, recruitment is undertaken by way of competitive examinations, which are supervised by the SSCS. However, anecdotal evidence indicates that actual practices differ.⁹⁵ Permanent employment is dependent on the results of an assessment after an obligatory probationary period of 12 months. Merit-based recruitment needs to be strengthened significantly in practice. To the extent that salaries are increased and decompressed, it will become more important to address weaknesses inherent in recruitment and promotion practices.

5.47 Greater attention to career development through merit-based promotions would enhance performance and provide civil servants with greater incentives to undertake professional development. Staff are appointed to a particular *category* according to educational qualifications. The only way a civil servant can change category is by acquiring the necessary level of education through attendance at college or university. Progressing from one *grade* to another can be done in three ways. The first consists of an assessment of the employee's abilities and performance by the ministry he or she works for, after a formal request from the civil servant. Each year in January, civil servants are supposed to fill in a professional evaluation form, which is in turn annotated by the department's head, though this is not commonly done in practice. Ideally, the form is then passed on to the SSCS, which forms an opinion of the quality of the employee and checks that this promotion corresponds to a vacancy in the relevant grade and that it is within the limits of the ministry's budget. The second way is for the civil servant to undertake long-term training at the Royal School of Administration. Finally, promotions can be achieved through an internal examination, which is also supervised by the SSCS. All grade promotions have to be ratified by the SSCS. Progression from one *class* to another is automatic with every two years spent in the civil service. In conjunction with its efforts to decompress salaries, CAR should review options for enhancing career development and strengthening the performance evaluation system for high level civil servants (category A).

⁹⁵ Each ministry or institution wishing to recruit civil servants sends a proposal to the State Secretariat of the Civil Service (SSCS), and then to CAR for approval. MEF addresses the financial aspects and, if approved, includes the proposal in the draft of the annual budget submitted for adoption by the Council of Ministers and the National Assembly. Only when the proposal is adopted by MEF and CAR is the agency able to undertake recruitment.

5.48 Based on the economic necessity for staff to undertake private paid work, controls over absenteeism, and other disciplinary functions, appear to be ineffective. Each ministry has inspectors that are supposed to monitor staff attendance, among other things, but they do not do so in practice. Punishment for moonlighting and absenteeism is rare. As salaries are increased, it will be important to reestablish the inspection function.

Information Management System and Establishment Control

5.49 In many respects CAR's Human Resource Management Information System (HRMIS) is an admirable system. It combines both Khmer and English languages and now contains a wealth of information about the civil-service workforce that was previously either unobtainable or difficult to obtain. Stringent validation procedures have been applied to ensure the progressive elimination of errors, and to ensure that data are comprehensive and accurate. There are, however, a number of issues that require attention.

5.50 While there are procedures for controlling the entry of names into the HRMIS database, the system itself cannot determine whether a particular appointment, promotion, or transfer is valid or even within budgetary limits. Though CAR has attempted to address some of these system weaknesses manually, no simple, comprehensive system exists at present for identifying individual posts in the civil service. This, in turn, means that there is no means for defining a link between a civil servant and a particular post. There is, therefore, no possibility of producing an establishment register, and thus there is not an adequate instrument for exercising control over the established workforce.⁹⁶

5.51 It appears, therefore, that establishment control is the weakest aspect of the system.⁹⁷ The key problem is the absence of any separate table within the database listing every post and assigning it a unique number. This, in turn, means that there is no uniquely definitive linkage between posts and employees and no possibility of producing a comprehensively accurate establishment register.

5.52 While the total number of posts in a particular establishment could probably be inferred, such a reconciliation would almost certainly have to be performed manually, as the system could not do it, and there would be no guarantee of its accuracy.⁹⁸ In such circumstances, the whole point of an establishment control system would be defeated. Moreover, over time, it would become progressively harder to ascertain what a baseline establishment figure

⁹⁶ Ministries, departments, units and post designations have all been appropriately coded and these details are held in separate tables within the database. There appear to be approximately 100 post designations in addition to the requisite number of ministerial, provincial unit and department codes (in database programming terms, devising and entering these codes would not have been a significantly difficult task and it is reasonably safe therefore to assume that this has been achieved to a high level of accuracy). All these codes are unique. They do not and cannot, however, uniquely define each post, because the posts themselves are not included in the system, and there appears to be no method of doing so, i.e., no consistently reliable and individual post identification and numbering system in the ministries/provinces.

⁹⁷ There does not appear to be any provision for holding the following, typically necessary, information about each post: date of financial approval for the post's creation, type and amount of allowances attached to the post, and status (i.e. permanent or temporary, full- or part-time). This also means that additional information on salary scale and appropriate grade/classification, which would be useful to collect, is not included (as is common in traditional French systems).

⁹⁸ This could be done by noting the total of sequentially-numbered employees on each monthly payroll, (together with any vacancies indicated as such), and cross-checking the figure with some other list or total obtained elsewhere giving the number of approved posts in that establishment (this latter figure would presumably remain fairly static from month to month, though it probably would not have been subject to the same validation tests as the staff data). By such a means, it might also be possible to ascertain whether the particular ministry had exceeded its authorized establishment, i.e., employed more people than it was entitled to do, or possibly fallen short of its requirements.

should be, or should have been at some pre-determined point, i.e., the system's inception or the beginning of a financial year.

5.53 The importance of the lack of an establishment register cannot be underestimated. Without the ability to produce an establishment register, the system cannot properly control posts and staff within ministries and provinces, because, as outlined above, it cannot assign a unique relationship to each. The current process of validating appointments, promotions and transfers depends heavily upon the instituting ministry/province. There is no way of independently validating or verifying the information provided. This clearly indicates that, although the HRMIS is at present a completely centralized function, it is limited to a purely reactive role. It only records, rather than independently authorizes and verifies, the data provided to it. Moreover, the high percentage of resources spent on contractual workers and overtime further argues the case for tighter establishment control.⁹⁹ The possibility of artificial/unapproved or purposely-inflated establishment totals being used by particular establishments would be considerable and very difficult to correct. It is therefore necessary that the Government create an establishment register to improve civil service management and budgetary control. The Government is well-placed to strengthen establishment control based on its previous reform efforts and building on its promising HRMIS.

Recommendations

- Develop options for improving management and control of civil service employment, including formulation of an establishment register proposal, and piloting of the proposal in select ministries.
- Integrate the HRMIS database into the budget preparation process by providing access to MEF and (read only) access to line ministries.
- Improve establishment control across the civil service based on fine tuning of the pilot experience.
- Develop effective monitoring mechanisms to assess civil servants' performance and introduce disciplinary measures to promote better performance.

CONCLUSION

5.54 This chapter argues that given the serious constraints on civil service capacity, a comprehensive pay and employment reform program is needed. Such a program would significantly improve civil service pay, particularly for essential skills, rationalize civil service employment and deployment, and strengthen civil service management. From the donor community to NGOs to public officials themselves there is clear agreement that low capacity in the civil service is perhaps the leading constraints on Cambodia's development. The urgency of the situation and potential impact of far-reaching reform means that the Government will be challenged to push itself considerably farther and faster than currently envisioned.

⁹⁹ The procedures for authorizing and calculating overtime compensation should be reviewed, especially as the new automated payroll system (and hardcopy pay bill) does not seem to include a column for overtime compensation.

APPENDIX 5.A

1 **The purpose of this appendix is to present different scenarios as a function of changes in three key variables.** Based on the variables defined in Table 5.6 (A, B, and C, above, highlighted), a sensitivity analysis was conducted.

Three scenarios were analyzed:

- a. *Pessimistic* - 0.3 percentage point reduction in revenues/GDP (0.3 percentage points lower each year), no revisions in the wage bill ceiling, and no shift in composition from DS to CA;
- b. *Improved* - 0.2 percentage point increase in revenues/GDP (0.2 percentage points higher each year), wage bill ceiling set at 42 percent, and 1 percent annual change in composition from DS to CA;
- c. *Optimistic* - 0.3 percentage point change in revenues/GDP (0.3 percentage points higher each year), wage bill ceiling set at 45 percent, and 2 percent annual change in composition from DS to CA.

2 **The scenario analysis shows that, based on existing macroeconomic and fiscal assumptions, significant gains can be made within the Government's medium term resource envelope, assuming reallocations from non-wage operating and maintenance costs (including efficiency gains) to the wage bill and assuming reallocations from the DS to the CA wage bill (see Table 5A.1).** Vis-à-vis the base case, the total civil administration wage bill in 2007 can be 17 percent higher under Scenario III, or as much as 39 percent higher under the more optimistic Scenario IV. In US dollar terms, under Scenario III it is feasible to expect average monthly wages in the civil service¹⁰⁰ to increase to approximately US\$ 72, while average wages could reach US\$ 85 under the optimistic scenario. While the use of averages necessarily entails a gross calculation, the analysis indicates that there is room for maneuver under existing macroeconomic and fiscal projections.

Table 5A.1: Civil Service Average Monthly Wage Projections, 2003-2007 ^{a/}

	2003	2004	2005	2006	2007
I. Base case	35	41	47	54	61
II. Pessimistic Scenario	34	40	46	52	60
III. Improved Scenario	38	46	53	62	72
IV. Optimistic Scenario	42	51	60	72	85

Source: WB staff estimates.

^{a/} Based on CAR's projected workforce size (2007 set equal to 2006).

3 **Given tight fiscal constraints and the low level of wages, an analysis of the impact of a reduction in size of the civil service should also be undertaken.** A very preliminary scenario analysis is presented here for the purpose of stimulating discussion rather than proposing specific policies or targets. Retrenchment would have to be accompanied by adequate departure packages, as envisioned by CAR, and possibly other measures (e.g., retraining). Three scenarios are considered¹⁰¹:

¹⁰⁰ Civil service wage bill projections subtract salary costs for the royal, legislative, and judicial branches, and also subtracts an estimate for overtime payments, and contractual and "floating" pay costs. Based on CAR estimates of the historical difference between the total civil administration wage bill and the civil service wage bill, the ratio of civil service to civil administration salary costs averages to 84 percent based on projections for the period 2003-2007. In 2002 CAR estimates that the cost of overtime and contractual and floating staff was nearly 14 percent of the total civil administration wage bill (overtime accounted for 10.7 percent).

¹⁰¹ Natural attrition is based on CAR's estimates (about 1.2 percent on average per annum).

- a. *SRCS baseline scenario*—in which a total of 15,750 civil servants are retrenched over the period 2003-2006, with most of the reduction occurring in 2005-2006;
- b. *Alternative scenario*—in which 31,500 civil servants (double the baseline scenario) are retrenched over the same period, with most of the reduction occurring in 2005-2006; and
- c. *Radical scenario*—in which the size of the civil service is set to be equal to one percent of the population by 2006 (assuming modest population growth of two percent over the period).¹⁰²

Table 5A.2: Projected Civil Service Size (Year End) by Scenario, 2003-2006

	2003	2004	2005	2006	GTR	NTR
I. SRCS Scenario (Base case)	166,381	165,953	164,595	163,469	15,750	1,900
II. Alternative Scenario	163,731	159,263	153,445	147,719	31,500	17,650
III. Radical Scenario	158,803	152,188	145,062	138,308	40,911	27,061

Source: CAR MTWF and World Bank staff estimates.

Note: Gross Total Reduction (GTR) is the sum of the number of retrenched employees only, while Net Total Reduction is the difference between the size of the civil service at the start of 2003 as compared with the end of 2006. All calculations in the table include attrition and new hiring as programmed by CAR.

5 The retrenchment analysis shows that in the first couple of years of the retrenchment program the gains are quite small and there is not much difference between the scenarios, taking into account the differential costs of severance packages (see Table 5A.3).¹⁰³ By 2007, however, the comprehensive and radical options yield more benefits as compared to the base case. The average monthly wage in the radical scenario, for example, is 18 percent higher. Yet, in absolute terms, salaries are still low.

Table 5A.3: Projected Monthly Civil Service Wage (US\$), 2003-2007

	2003	2004	2005	2006	2007
I. SRCS Scenario (base case)	34	40	45	52	61
II. Alternative Scenario	34	40	47	55	68
III. Radical Scenario	34	41	49	58	72

Source: CAR MTWF and World Bank staff estimates.

Note: Size of workforce in 2007 set equal to 2006.

6 A final simulation (see Table 5A.4), in which the retrenchment scenarios were combined with the wage bill scenarios, shows that a combination of policies—namely, increasing the wage bill ceiling as a percentage of expenditures, reallocating from defense/security to civil administration, increasing tax revenues, and retrenching staff—can have a significant increase on average remuneration.¹⁰⁴ For example, the projected average monthly wage in 2007 is nearly one-third higher in the alternative/improved scenario and nearly

¹⁰² Setting the size of the civil service equal to one percent of the population would place Cambodia on the low end of the low income countries spectrum of share of public sector employment to population. See Figure 5.3.

¹⁰³ Table 5A.2 presents the projected size of the civil service according to the three scenarios. Note that in each of the scenarios it is assumed that all reductions will come from the non-education sector. At the same time the projected data take into account normal attrition and programmed new hiring over the period, as estimated by CAR's MTWF. The next step was to estimate the cost of the retrenchment program, which was based on CAR data. It was assumed that each retrenched civil servant would receive a departure package, the value of which was equal to the average cost of eighteen months of wages (the annual average wage as estimated by CAR over the period was used to calculate the severance package values). The next step was to calculate the average monthly civil service wage after retrenchment (Table 5A.3).

¹⁰⁴ The alternative retrenchment scenario is combined with the improved wage bill scenario and the radical retrenchment scenario is combined with the optimistic wage bill scenario (the base line scenario remains the same in both cases). The only difference between Tables 5.7 and 5.9 is that Table 5.7 does not factor in retrenchment costs.

two-thirds higher in the radical/optimistic scenario as compared to the base case. These simple projections, which are intended as illustrative and not to prefigure any specific outcomes, show that, given the right policies, civil service remuneration can be increased from the Government's budget before resorting to international aid to fund pay reform.

Table 5A.4: Combined Wage Bill and Retrenchment Scenarios, Average Monthly Wage
(US\$) 2003-2007

	2003	2004	2005	2006	2007
Base case	34	40	45	52	61
Alternative Retrenchment Scenario + Improved Wage Bill Scenario	39	47	57	68	80
Radical Retrenchment Scenario + Optimistic Wage Bill Scenario	44	56	69	85	100

Source: SRCS, CAR MTWF, and World Bank staff estimates. Note: Size of workforce in 2007 set equal to 2006.

6. REFORMING INSTITUTIONS TO IMPROVE SERVICE DELIVERY III: DECENTRALIZATION

“The devolution of power carried out through decentralization and deconcentration will shift the focus of development towards the people with the view to implementing structural adjustment, strengthening grassroots governance, reducing poverty and inequality, and promoting gender equity at all levels.”¹⁰⁵

REFORM AGENDA AND INSTITUTIONAL FRAMEWORK

6.1 The RGC is undertaking a decentralization program to devolve power to newly created semi-autonomous elected governments at the commune and sangkat (urban commune) level and move toward enhanced roles for provinces and municipalities as deconcentrated entities of the center.¹⁰⁶ It is important to emphasize, however, that commune level reforms are in the very first stages of implementation, while provincial level reforms are still under development, though provinces and communes have existed as administrative levels of the central government since the French colonial era (the numbers and distribution of the various administrative structures are summarized in Table 6.1).¹⁰⁷ Decentralization, however, is considered a critical element of the public sector reform agenda (Governance Action Plan, 2001).

6.2 **Improving service delivery in the face of severe administrative capacity constraints will likely mean pursuing both devolution to the communes and further deconcentration to the provincial administrations.** Devolution in principle is “the transfer of authority for decision making, finance and management to quasi-autonomous units of local government (World Bank, 2000).” As yet, however, Cambodia’s decentralized communes have no mandated responsibilities and only very limited financing. While the communes may eventually become important service providers, this is not likely to happen for many years. Strengthening devolved provincial administration is a more promising near term measure, though deconcentration implies, by definition, less decentralization than devolution. The aims of this chapter are thus modest. First, it addresses commune level decentralization by offering some guidelines on further developing the devolved system. Second, it offers some suggestions for improving expenditure management and service delivery at the deconcentrated provincial level.

6.3 **As the Government proceeds to deepen and extend the commune decentralization process, it will need to further develop the legal and institutional structure as it pertains to: (a) expenditure and revenue assignment and management; (b) monitoring and evaluation systems; and (c) the inter-governmental transfer system.** On expenditure and revenue assignment, the priority is to undertake the necessary analytical work to inform the upcoming commune boundary review. On expenditure and financial management, the advantage is that the system is generally well-developed, though there are some procedural complexities that might

¹⁰⁵ “Cambodia: National Poverty Reduction Strategy,” December 2002, p. 108.

¹⁰⁶ “Provinces” is used throughout the rest of the chapter to denote both provinces and municipalities, while “communes” is used to signify both communes and sangkats, unless otherwise noted.

¹⁰⁷ The 1993 Constitution establishes provinces (*khet*) and municipalities (*krung*) as the principal territorial subdivisions of the Cambodian state. Provinces are further divided into districts (*srok*) and communes (*khum*), while municipalities (which have the same status as provinces in selected urban areas) are further divided into sectors (*khan*) and urban communes (*sangkat*). Villages exist in rural areas and urban areas.

prove difficult for the less experienced communes. These will need to be addressed. The challenge is to support implementation of the system by closely monitoring progress and to adjust and/or simplify the systems and procedures, if necessary. This entails the establishment of an adequate commune monitoring and evaluation system as a key strategic measure to safeguard the accountability across the decentralized system. The most immediate priority for further developing the inter-governmental transfer system is setting up the Commune/Sangkat Fund Board to manage fund resources transparently. Over the medium term, and tightly linked to devolution of specific functions to the communes, is the determination of the fixed resource share allocated to the communes and sangkats, which will be necessary for providing the communes with some measure of resource stability.

Table 6.1: Number of Districts/Sectors, Communes/Sangkats and Villages by Province/Municipality in Cambodia

No.	Provincial/Municipalities	Districts/Sectors	Communes/Sangkats	Villages
1	Bantey Meanché	8	64	623
2	Battambang	13	96	733
3	Kampong Cham	16	173	1,758
4	Kampong Chhnang	8	69	553
5	Kampong Speu	8	87	1,308
6	Kampong Thom	8	81	732
7	Kampot	8	92	478
8	Kandal	11	147	1,087
9	Kok Kong	8	33	130
10	Kraches	5	46	250
11	Monduliri	5	21	90
12 ^{a/}	Phnom Penh	7	76	637
13	Preah Vihear	7	49	208
14	Prey Veng	12	116	1,137
15	Pursat	6	49	501
16	Ratanakiri	9	49	240
17	Siem Reap	12	100	875
18 ^{a/}	Sihaknouk Ville	3	22	94
19	Steng Treng	5	34	128
20	Svay Rieng	7	80	690
21	Takeo	10	100	1,116
22	Otdor Meanchey	5	24	231
23 ^{a/}	Key	2	5	16
24 ^{a/}	Pailin	2	8	79
	Total	185	1,621	13,694

^{a/} Denotes municipality, sectors, sangkats, and villages.

Source: Prakas No 493 PRK, on Number, Name and Boundaries of the Communes and Sangkats of the Kingdom of Cambodia, 30 April 2001.

6.4 As the RGC moves forward with its development of a plan to deconcentrate responsibilities to the provinces, work on a number of preparatory measures would smooth the transition. First, there is a need for an overarching deconcentration framework and analysis of options for Cambodia, with a focus on the objectives to be achieved through deconcentration. CAR, which is charged with developing the framework, should provide a clear set of guidelines to the sectoral ministries for developing approaches, and needs to coordinate this work closely with them. This framework should also address the relationship between provincial governors and line ministries provincial administrations. Second, there is a need to improve coordination between ministries and provinces on expenditure management, given the finding that there is no positive correlation between poverty incidence, or the number of poor, and provincial budget allocations for health, education or other sectors, which results from high expenditures on

administrative overhead and a lack of alignment between provincial spending and sectoral priorities. In the short term, sectoral earmarking at the provincial level would allow line agencies to improve pro-poor targeting of spending.

6.5 Weak institutional capacity at all levels remains a great challenge to designing and implementing decentralization and deconcentration reforms. Strengthening capacity, both in terms of training commune and provincial level civil servants and clarifying the institutional support structures for decentralization and deconcentration reforms, is critical for success. This also would entail clarifying the role of villages in the commune structure. The most important ingredient for success, however, is likely to be meaningful accountability relationships between local elected officials and citizens. Bolstering and safeguarding the democratic integrity of the commune system is an important challenge for the Government.

DECENTRALIZATION TO THE COMMUNES AND SANGKATS

6.6 The first commune elections were held in February 2002. The commune councils are elected with a five-year mandate. Councils consist of five to eleven members depending on the population and location of the commune. The councils are elected on a proportional basis, such that more than one political party can be represented. The president of the council (commune chief) is the individual who receives the most votes on the majority-party candidate list.

6.7 The legal foundation of decentralized government is straightforward, and is composed of two laws passed in 2001 on commune administrative and electoral systems. The 2001 Law on Commune/Sangkat Administrative Management does not assign mandatory sectoral responsibilities to the communes and sangkats. At this early stage, it simply provides a framework in which the communes are empowered to: (a) maintain public order and security; (b) organize and manage public services; (c) enhance the welfare of citizens; (d) promote socio-economic development and upgrade living standards; (e) protect and preserve the environment, natural resources, and culture; (f) coordinate citizens views in order to promote tolerance and mutual understanding; and (g) perform general affairs to respond to the needs of citizens.

6.8 Mandatory functions have not been assigned because many communes have little or no service delivery capacity. In many countries, decentralization (in the sense of devolution) refers to the transfer of existing functions and resources from a higher to a lower level of government. Accordingly, the strategy of initially empowering communes to cover only limited administrative functions and to provide a few services that are local in nature (and have not previously been provided to any significant extent by the central government) is a pragmatic way to develop the commune system, as long as it is properly embedded in a larger program of public sector reform.

6.9 However, the lack of assigned functions means that communes have no mandated expenditure responsibilities. Assigning functional responsibilities is typically regarded as the first step in the process of devolution. The design of the inter-governmental transfer system and the granting of own-source revenue rights—allowing for sufficient funding to meet expenditure obligations—would then follow. Cambodia's strategy is to allow communes to identify initial priority services through participatory mechanisms and to develop them locally, which should stimulate some basic local capacity and build connections to residents. While this strategy is reasonable as a first phase, given capacity constraints at the commune level, the Government should develop a plan and methodology for phasing in mandated responsibilities over the medium term for two reasons. First, the question of the adequacy of inter-governmental transfers and own-source revenues cannot be addressed in a vacuum. Second, there is a risk that lack of coordination with national ministries might result in duplication of functions, thereby decreasing the efficiency of resource use (and possibly resulting in more wasteful spending on general administration).

Though transfers to the communes presently account for a small share of total government spending, resource scarcity and poverty reduction demand that they are spent efficiently. Allocations to the communes have an opportunity cost, and while it may be that the marginal benefit of commune expenditure is higher than the opportunity cost of line ministry expenditure, such an outcome should not simply be assumed.

6.10 The RGC should develop a strategy for devolving service delivery responsibilities to communes—and adapting the role of line agencies—as the system matures. If it is found, for example, that the majority of communes are spending on water supply and irrigation services, the Government should consider devolving these functions to the communes and then revamp line agencies currently responsible for these functions so that their role changes from direct service provision to regulation and oversight. The general principles of expenditure assignment are well-known from the decentralization literature (see, e.g., McLure and Martínez-Vázquez, 2002). The principle of subsidiarity, which states that services should be delivered by the level of government to which the benefits accrue, and thus depends foremost on the size of local government entities, is of particular relevance for Cambodia at the moment in light of the upcoming commune boundary review (mandated to occur before the July 2003 elections).

6.11 The commune boundary review will have a major impact on the type of services that communes can provide and on the types of own-source revenues that communes can collect. The commune boundary review should thus be guided by explicit analysis of assumptions about expenditure and revenue assignments. For this reason the review will need to be supported by analysis that addresses both of these assignment issues. Moreover, as is the case in many countries, it is clear that one system will not fit both the urban and rural sectors. The Government could take advantage of the boundary review to clarify differences in expenditure and revenue assignment between communes and sangkats, and to further elucidate the relationship between sangkats and municipalities.

Inter-governmental transfers

6.12 Communes are entitled to receive revenues from the national budget as well as to collect their own revenues (they are not allowed to borrow). Communes are required to use national guidelines to establish a system for the management, monitoring and control of their finances. The Commune/Sangkat Fund (CSF), whose sub-decree was approved by the National Committee to Support the Communes (NCSC) in February 2002, is capitalized from domestic and external sources. The contribution from the RGC budget in 2002 was US\$ 5 million (1.2 percent of recurrent domestic revenue). According to the MTEF, the contribution is expected to grow to 2.5 percent, or US\$ 12 million in FY 2004 (see Table 6.2). Though the law requires that a share of the RGC budget be allocated to the CSF, the obligation is not statutorily defined. Fixing an allocation in due course—once there is greater clarity about expenditure assignment—would be necessary for providing the communes with some measure of resource stability.

6.13 CSF resources are held in the NT and transferred to provincial treasuries, where each commune has an account. The CSF is to be managed by a CSF Board, which is responsible for setting CSF policies. International experience suggests that it is good practice to have a separate and more independent management structure for this type of fund rather than housing it under an existing ministry or committee. MEF chairs the Board, and other RGC members are drawn from MOI, MOP and the CDC. In addition, three representatives of commune councils will be selected by MOI. The Board is not yet functioning because no CS representatives have been chosen. A Technical Secretariat to support the Board, however, has already been named by the MEF. While

the CSF Board is being set up, control over CSF resources is vested in the NCSC. Establishing the Board as planned is a critical next step in the decentralization process.¹⁰⁸

Table 6.2: Intergovernmental Transfers to Communes: Base Case Resource Envelope
(CR billions)

	2002	2003	2004	2005
	Budget	MTEF	MTEF	MTEF
Total domestic recurrent revenue	1,791	2,035	2,286	2,547
Commune Fund as % of recurrent revenue	1.1	2.0	2.5	2.5
Commune Fund (CR millions)	20	40	57	63
Distributed as:				
Recurrent expenditures	6,660	13,551	19,030	21,207
Capital expenditures	13,340	27,142	38,117	42,478

Source: MTEF.

6.14 Governors are required to prepare quarterly reports on CSF operations for MOI. Based on this information, MOI/DOLA is required to prepare quarterly reports for the CSF Board. The CSF Board Secretariat is required to prepare reports for the RGC and all donors and international financial institutions that support the CSF Fund.

6.15 CSF transfers are divided into general administration (GA) and local development (LD) components.¹⁰⁹ The CSF Board sets component weights, but the GA cannot exceed 30 percent of the total and the LD cannot be less than 70 percent. The GA share is allocated to communes in proportion to the number of councilors. The LD share is allocated according to a formula with three components: equal share, a share proportional to population, and a share proportional to relative poverty. The CSF Board determines component weights subject to the constraint that at least 40 percent must be based on the poverty component. The FY2002 allocation formula, however, used weights for the equal share, population, and poverty components, respectively, of 50, 30 and 20 percent.

6.16 Commune councils were divided into two CSF allocation groups in 2002. The more advanced ones (category 1—506 of 1,621 in 2002) that participated in Seila received full allocations (GA and LD), while new communes (category 2) only received GA funds. In 2002, a total of US\$ 6.42 million dollars was allocated to the communes. Of this amount, US\$ 2.21 million was allocated for the GA component and \$US4.21 million for the LD component. The highest LD allocation to a single CS is US\$15,530 and the lowest is US\$5,400 in 2002.

6.17 It would be preferable to adopt a more graduated approach to phasing in access to development resources based on capacity and performance. A recent proposal has suggested doing away with category 2 status and creating two category 1 groups, 1-A and 1-B, with the former receiving the full and the latter a much reduced LD allocation. This does deal with the problem of some councils having no resources to deliver services, but it uses inappropriate criteria for ensuring that higher status communes can spend resources wisely. If weaker councils initially received small development grants, those performing adequately could be successively

¹⁰⁸ Verify status.

¹⁰⁹ CSF resources are held in a deposit account in the NT. RGC budget contributions to this account are to be transferred in three installments: 50 percent on or before March 1, 30 percent on or before June 1, and 20 percent on or before September 1. External contributions to the CSF account are supposed to be transferred from an MEF foreign deposit account in the NBC maintained to receive grants and loans from donor agencies and international financial institutions, however in practice this has not yet happened (e.g., the CSF deposit account in the NBC has not yet been established). The use of commercial banks will be piloted in some provinces in 2004.

awarded larger amounts in subsequent years until they reached the full allocation. The transfer system could also be generally used to provide hard incentives for all communes (by using *ex post* sanctions for poorly performing communes, e.g.). The plan for 2003 is for all communes to receive the LD allocation.

6.18 There is some concern that councilor allowances approved in May 2002 seem high relative to the part-time effort required of elected councilors. In the aggregate, these allowances have also come up against CSF principles, which state that a maximum of 30 percent of CSF allocations should be devoted to administrative expenses.¹¹⁰ The broader issue, however, is that the overall level of commune administrative expenses is high, and that in some communes administration funds are the only resources being provided.

Own-source revenues

6.19 Commune councils have the right to raise own-source revenues (OSRs), namely tax and non-tax revenues and service charges. The decentralization law assigns land, real estate, and rental taxes to the communes, but it does not provide details. The law requires further elaboration of the commune revenue sources, including types, rates and collection processes. It also requires RGC compensation for agency functions performed by communes on behalf of a state agency.

6.20 Previous experience with raising revenue at the commune/village level is limited to three types. The first are fees unrelated to government that are paid to community structures (e.g., pagoda committees) and local NGOs to build or maintain facilities. The second includes contributions required by international organizations for development projects, such as ILO rural roads or UNICEF water and sanitation projects. The third is the system of capital and recurrent contributions used under Seila.

6.21 Developing commune OSRs will be essential, over the medium term, for ensuring financial sustainability, and is regarded by the RGC as a key element of its “second phase” of decentralization. MEF and NCSC are planning to build on Seila experience in the early stages of fiscal decentralization to communes, but there has been no concrete action to date. Initial sources will likely include a betterment levy-type assessment structured as a contribution for local infrastructure improvements paid by the beneficiaries.¹¹¹ A second near-term source is likely to be user charges for selected local services.¹¹² One short term option here would be the transfer of the animal slaughter (abattoirs) tax from the provinces to the communes, to give the communes a small source of revenue and allow them to develop collection capacity.¹¹³ In addition, communes are to be allowed to impose fees currently charged by the central/provincial government for administrative services, such as birth, marriage and death registration, and to share in land

¹¹⁰ The allocation to administrative expenses in 2002 was closer to 45 percent of total transfers from the center, but the portion over and above the 30 percent allocation is mostly funded from the provincial budget line that used to finance chiefs when they were MOI employees.

¹¹¹ Betterment levies will be most beneficial for urban areas, but they could also be used to finance certain types of rural infrastructure as well. The Municipality of Phnom Penh has already tested with some success this funding arrangement for the rehabilitation of streets and pavements. The CSF is supposed to require some minimum local commitment of funds for infrastructure investments, which may vary by type of public service. The CS will then have flexibility to charge more than the minimum and will decide, given central guidelines, how to apportion the assessment among CS residents.

¹¹² The Municipality of Phnom Penh, for example, charges for water and requires households to pay for the cost of sewage service through a 10 percent charge assessed on the water consumption bill. Some of the Seila program rural communes have developed user fees for selected services.

¹¹³ The animal slaughter tax constituted 1.2 percent of provincial OSRs in 2002 (budget estimate).

transfer fees.¹¹⁴ National guidelines for setting user charges need to be developed, but CS will require some flexibility in implementing them. Further analytical work on alternative commune revenue bases should be undertaken before further developing the OSR legal framework.

Commune planning, public expenditure, and financial management

6.22 The decentralization legislation requires all commune councils to prepare a simple 5-year Commune Development Plan (CDP) and a 3-year rolling Commune Investment Program (CIP). The commune Planning and Budgeting Committee (PBC), the only committee required to date, assists the chief with preparation. Participation is facilitated through a broad-based Planning Forum, which comprises all council members, two representatives (one male and one female) from each village, and one representative from each NGO registered with the council.¹¹⁵ The commune council is required to monitor and prepare annual reports on CDP implementation for its constituents, the RGC, and donors who fund the CSF (the report must be prepared by the CS chief and the PBC and approved by the council. A comprehensive report on the results and impact of the CDP is required six months before the expiration of the council's mandate.

6.23 Commune councils are required to actively promote and coordinate mechanisms for consultation with residents, civil society organizations, and community groups. Councils are expected to provide training, printed materials (such as handbooks), and education to the public. Commune residents can attend council meetings, and the chief is responsible for encouraging them to do so. They cannot vote, but they can ask questions and make written complaints or suggestions to which the council is obligated to respond. Commune councils are required to set up information boards at headquarters and every constituent village to display official council notices, including plans and budgets, as well as other relevant news and information.

6.24 The commune budget, which is the responsibility of the commune chief, assisted by the PBC, is to be based on the CDP and CIP.¹¹⁶ The budget is intended to be formulated through an extension of the participatory planning process, but it is not yet clear how genuinely participatory the process is in practice. Budget amendment is allowed, but specific procedures must be followed unless the amendment simply involves reallocation of resources within an approved expenditure category (and under its ceiling) or altering investment projects. The governor is responsible for ensuring compliance with budgeting rules, but has no right to demand alteration of the budget if legality requirements are met.^{117,118}

6.25 A separate commune accounting and payment system (cash-based with double entry recording) has been established to record transactions, produce required reports, and to provide a basis for monitoring budget implementation. The chief is the budget officer and has responsibility to authorize revenue collection, commit expenditures, and order payments in accordance with the approved budget. Only non-tax revenues can be collected directly by the communes (by a council-appointed revenue collection officer), and only minor payments are made directly through a petty cash system. The PTs, which serve as commune accountant, handle most commune financial activities, including: (a) collection of revenues, (b) execution of

¹¹⁴ This has already been approved by NCSC, as has a joint MEF-Ministry of Land Management, Urban Planning and Construction (MOLMUPC) prakas on sharing land transfer fees with the CS.

¹¹⁵ Over time coordination between planning at the commune and provincial levels will have to be addressed.

¹¹⁶ The CIP is to cover the projects to be financed in full or in part with the CSF allocation and to include documentation of co-financing from own sources and any other sources. The annual component of the CIP is supposed to be reflected in the capital expenditure section of the commune annual budget.

¹¹⁷ The March 2002 Sub-decree on the Commune/Sangkat Financial Management System and subsequent budget-related guidelines issued by MEF lay out the details of the recurrent and capital revenue and expenditure budgets.

¹¹⁸ If there is an irresolvable conflict between the governor and the commune chief, the Minister of Interior mediates and makes the final determination on the case.

payment orders issued by the commune chief, (c) release of funds, (d) recording of transactions, (e) preparation of periodic financial reports, and (f) management (viz., filing and safeguarding all commune financial documents and records. PTs are also charged with monitoring commune finances. The councils are subject to audit by the NAA (and non-government auditors are required by CSF donors). The commune chief, accountant, and others involved in budget implementation are legally liable for undertakings that result in excess expenditures, unauthorized adjustment of appropriations, and any other act detrimental to commune finances or property. Disciplinary procedures allow the council to deal with councilors who do not meet obligations, and sanctioned councilors may be removed and replaced according to MOI procedures.

6.26 The procurement of works, goods and services must be undertaken in a manner consistent with the general principles followed by the RGC. Small purchases can be evaluated by the chief or a delegate. For larger transactions, a procurement committee appointed by the chief manages the process. The committee must include the chief or a delegate (chair), two council members, and a clerk (secretary). Prior to procurement for a development project, the commune needs technical clearance from the relevant provincial department through the Provincial Office of Local Administration (POLA), although clearance is assumed if the department does not respond within fifteen days of submission. Details of the bidding and award process have been clearly specified. Under unusual and limited circumstances, the provincial governor may authorize a waiver of competitive procurement. At the commitment stage, a contract or agreement consistent with the budget is negotiated. The verification process requires the chief to ensure that goods have been delivered/services rendered and the supplier invoice is correct. At this point, the chief issues a payment certificate, which is processed by the PT.

6.27 The communes are required to prepare various financial reports. These include: (a) monthly and mid-year budget implementation reports in the form of a revenue and expenditure statement consistent with the budget classification system; and (b) a set of annual financial statements, including an annual revenue and expenditure statement, reconciliation of the commune's PT deposit account, and a fixed assets statement. The commune accountant at the provincial treasury must prepare these closing financial statements according to specified procedures, and the council must approve them.

6.28 The system of commune planning and budgeting is generally well developed at the conceptual level, largely because it benefited from six years of Seila experimentation, though a few aspects of the system require further consideration. Concerns have been raised about the possible complexity of the commune planning process, which includes five phases and eleven steps that require substantial time and input from broad segments of the local community. To the extent that this process could be simplified—without compromising community participation—it would be less taxing of local capacity. Second, the process for channeling funds to communes in three installments that require certain conditions to be met has been criticized as overly burdensome. A two-installment process might make more sense.

6.29 The picture is less clear regarding the implementation of financial management practices at the commune level. The major concern is that commune financial management procedures are different from the regular (national and provincial) procedures, which further fragments the system. The PTs act as cashiers but authorization of expenditure rests solely with commune chiefs. There is no pre-audit requirement and it is not clear what other audit arrangements will be in place, raising concerns about fiduciary accountability. A related issue is the flow of funds to the PTs during the year, which are likely to be either erratic or back-loaded, given systemic weaknesses. Concerns have also been raised about the complexity and demanding reporting requirements of the commune level PEFM process. Thus, it is important for the NCSC, presumably with MEF in the lead role, to monitor the implementation of planning, budgeting, and financial management processes, and to be willing to adjust and/or simplify the systems and

procedures, if necessary. Close scrutiny may require special monitoring of a sample of communes in order to gain a greater understanding of the system's actual operation. These concerns are likely to be especially relevant in the provinces and communes that did not participate in Seila Phase I.

Institutional development and monitoring

6.30 The Law on Commune/Sangkat Administrative Reform gives the Ministry of Interior (MOI) responsibility for determining procedures for monitoring and control of the general activities of the communes/sangkats. Three major types of monitoring and control are expected. The first is to ensure that communes are meeting all legal requirements in performing their duties. The second is to assess the degree of development of commune capacity. The third is to assess the nature and extent of interventions and assistance needed to develop commune capacity.

6.31 The MOI has set up the Department of Local Administration (DOLA) to perform these functions. DOLA currently has one or two staff in each province and will eventually set up a Provincial Office of Local Administration (POLA) in each province. MOI may also delegate to the province or district level any functions related to monitoring and control of the communes. Finally, the presence of the commune clerk, who is a direct-hire employee of MOI, gives MOI a window into the day-to-day operations of the commune councils.

6.32 The provincial governors are required to prepare quarterly reports on the operation of the CSF for the MOI. These, at a minimum, must include information on: (a) communes entitled to transfers, (b) communes complying with conditions of access and receiving transfers, (c) amounts transferred to each commune, (d) allocation of CSF resources in each commune for recurrent and investment expenditures, (e) specific types of investments supported by CSF resources, and (f) levels of own-source revenues mobilized by the councils. Based on this information, DOLA is required to prepare comprehensive quarterly reports for the CSF Board (the CSF Board Secretariat is required to prepare comprehensive reports for the RGC and all donors and international financial institutions that support the CSF Fund). *Supporting DOLA's ability to establish a commune monitoring and evaluation system will be a key strategic measure for safeguarding the accountability of the decentralized system.*

Recommendations

- Operationalize the Commune/Sangkat Fund Board.
- Undertake further analytical work on commune expenditure assignment and alternative commune revenue bases—as inputs to the upcoming commune boundary review—before further developing the legal framework.
- Provide greater support to DOLA for the establishment of a commune monitoring and evaluation system in order to safeguard the accountability of the decentralized system.
- The NCSC, with MEF in the lead role, should closely monitor the implementation of the planning, budgeting, and financial management processes with a willingness to adjust and/or simplify the systems and procedures, if necessary.

DECONCENTRATION TO PROVINCES AND MUNICIPALITIES

6.33 Developing stronger deconcentrated sectoral offices at the provincial level is necessary for improving service delivery. Basic public services are being provided inadequately in many parts of the country, and national poverty alleviation goals cannot be met without better performance. Enhancing the capacity of the provinces will improve delivery of national priority services, some aspects of which might eventually become formal commune responsibilities as the

system matures. Improving the functioning of the provinces, however, is not simply an exercise in capacity building. Presently, many of the structures, systems and procedures in place for provincial operations are underdeveloped, and some are in need of reform. A careful and detailed evaluation of the broader provincial fiscal and managerial structure is needed, as is special attention to the specific needs of particular sectors. As with the commune system, the provincial system cannot be developed in isolation, which appears to be a danger under the present RGC approach to reform. The relationship of the provincial to national public sector reforms and the emerging commune system must be carefully considered.

6.34 At the same time, there is a need for an overarching deconcentration framework and analytical work on options for Cambodia. The RGC has not been clear about the objectives it hopes to achieve through deconcentration. Is the main intention to improve provincial and district capacity to perform functions on behalf of the RGC, or will provinces be given more autonomy? If the former, which functions should be the responsibility of the provinces, and how and when will they be developed? If the latter, how will political accountability to service users be ensured? Clarifying the direction of the reform will also inform the design of the provincial budget system. CAR, which is developing a framework for deconcentration, needs to provide a clear set of signals and guidelines to the sectoral ministries for developing approaches and mechanisms, and needs to coordinate closely with line ministries and others on the development of the framework. This does not, however, mean that all ministries have to approach deconcentration in exactly the same way. CAR needs to do adequate background work to ensure that the principles it develops are broad and flexible enough to accommodate the likely diverse requirements of different sectors.

6.35 The legal foundation of deconcentrated government is straightforward, and is composed of the 1993 Law on State Financial Systems and the 1998 law on provincial finances, known as the “provincial budget law (PBL).” The Law on State Financial Systems defines vertical lines of accountability for sectoral departments and authorizes MEF and the NT/PTs to manage most provincial finances. The PBL defines provinces as legal entities headed by governors and allows them to prepare annual budgets, which must be balanced, to make specified expenditures and collect specified revenues. Governors serve as budget officers for provincial departments financed through the RGC budget, and they also maintain a separate budget for their functions (the “Salakhet,” or governor’s budget).

The Governor’s budget

6.36 On the expenditure side, the greatest share of the governors’ budget is spent on operating expenditures, primarily administrative operating costs (78.8 percent of the total). The Salakhet is subject to the control of MOI, and as of 2001 is reflected in Government expenditure reports (viz., the TOFE). In 2001, the Salakhet was equivalent to about 20 percent of the provincial component of the RGC budget. On the revenue side, tax revenues account for 48 percent of the total, with the tax on motor vehicles (17.4 percent), the excise on public lighting (12.3 percent), the wealth transfer tax (7.0 percent), and the business tax (6.8 percent) the most important (Annex A Tables A15 and A16 provide revenue and expenditure information from the 2002 Salakhet). Subsidies from the RGC budget are the second most important category of provincial revenues at 41.3 percent. There is, however, great variation in the importance of revenue sources across provinces. The second most important category is provincial and municipal subsidies (9.2 percent), followed by salaries and allowances (7.6 percent). As with revenues, there is considerable variation across provinces, but non-salary operating costs dominate in all cases.

6.37 Given the scarcity of resources, the Salakhet is not an insignificant amount of expenditure. In order to make sure that Salakhet expenditures are aligned with RCG priorities as

outlined in the NPRS, an efficiency analysis of these expenditures should be conducted (based on monthly reports provided to MEF), as it appears that nearly 79 percent of total spending is for “administrative management.” If and when, over the medium term, the role of the provincial administration is redefined, the need for and role of the Salakhet would need to be revisited.

Provincial department expenditures

6.38 The provincial budget of the central government is financed primarily from transfers from the central government. Transfers to the provincial budget have increased in recent years, from US\$ 270,000 in 1998 to US\$ 6.4 million in 2001, but still only account for 1.5 percent of Treasury-executed expenditure, with further increases programmed for 2003 to 1.7 percent.

6.39 While it is difficult to give a complete picture of the structure of deconcentrated agency spending by level of administration, since expenditures of central agencies will include goods and services provided to provinces and sub-provincial administrations, the breakdown of central and provincial expenditures points to a high degree of centralization. Table 6.3 presents the provinces’ share of civil administration spending allocated to institutions, excluding charges to central government, such as debt servicing. This shows a marked decline in the provinces share of Treasury-executed expenditures from 41.9 percent in 1996 to 28.6 percent in 2001 (while rising in dollar terms from US\$ 69 million to just over US\$ 90 million in 2001), followed by a recovery to 39.1 percent in estimates for 2002. Most of this increase is accounted for by increases in provincial expenditures for just two functions: general administration and public works. In critical service delivery sectors such as health, education and agriculture, where resources have to be dispersed to service providers at the field level, there is a trend since 1996 toward the further concentration of resources in the hands of the central agency, indicating a lack of progress since the 1999 PER. Estimates for 2002 and programmed expenditures for 2003, however, suggest a slight reversal of this trend in agriculture and health. Taking into account PAP spending in education, which is posted under central departments but actually spent by provinces and districts, there is a slight improvement in the level of deconcentration from 1999-2002.

Table 6.3: Expenditure by Provincial Administrations as a Share of Total Expenditure by Function

Function	1996	1997	1998	1999	2000	2001	2002E	2003B
Core Government	5.9	5.3	3.9	3.0	3.1	3.9	8.2	11.3
General Administration	21.2	20.4	10.1	7.9	5.7	7.1	16.7	23.0
Judiciary	40.2	46.2	41.0	47.7	48.2	46.2	46.1	44.8
Economic Services	18.0	11.6	13.2	11.6	12.0	9.8	23.4	22.1
Agriculture	37.3	27.4	31.7	40.3	28.3	20.0	31.2	30.9
Transport	19.8	10.5	17.0	16.0	7.0	5.6	40.9	34.4
Public Works	23.3	16.6	24.2	18.9	7.6	6.7	55.6	51.1
Other transport	-	-	-	-	-	-	-	-
Other Economic Services	8.9	6.0	5.9	4.4	8.6	6.9	12.4	12.1
Environmental Protection	37.5	39.0	34.9	33.0	31.0	19.0	25.5	25.3
Rural Development	22.7	29.3	19.4	11.9	32.7	19.0	39.5	40.4
Social Services	73.9	68.9	73.1	57.0	62.6	60.0	56.2	54.7
Health	38.8	28.0	28.9	16.3	30.8	31.1	34.4	34.6
Recreation, Culture & Religion	36.3	31.5	30.0	28.7	12.2	11.7	19.7	17.9
Education	83.0	83.8	84.8	76.9	78.1	73.2	63.2	61.6
Social Protection	95.5	93.0	95.6	94.4	86.9	87.4	83.8	85.0
Total	41.9	38.1	32.4	30.3	28.3	28.6	39.1	40.1

6.40 Provinces spend a much larger share of their budgets on personnel than the central agencies, and a commensurately smaller proportion on operations and maintenance. TOFE reports do not identify provincial capital expenditures, because they are centrally-executed,

though a significant share of the Government's capital expenditures are made at the provincial level, primarily for road rehabilitation. There has been some improvement in education and health, where PAP has facilitated the deconcentration of resources to cover operational costs at the field level.

6.41 Calculations show that there is no positive correlation between poverty incidence, or the number of poor, and provincial budget allocations for health, education, or other sectors (see Table 6.4). In fact, correlation coefficients are negative for 2002 (note that these calculations do not take into account PAP spending, which may improve the correlations). Allocations are largely a function of population size: the larger the province, the larger the allocation. However, per capita allocations for smaller provinces are much larger than those for larger provinces, presumably because the costs of running a provincial administration are much the same whatever the size of the province. While true of both health and education, the impact of the administrative overhead is much more apparent in other sectors, presumably because administrative overhead represents a larger share of total expenditures in the other sectors. In both the health and education sectors, the ratio between budgeted personnel and operation expenditures varies by a factor of two or more between provinces.

Table 6.4: Allocation of Health, Education and other Provincial Agency Budget Allocations by Province, 2002 (CR)

Province	Population 000	% Poor	Health	Per Capita Educ.	Other	Salaries: Health	Operations Education
Phnom Penh	919	12	2,849	18,179	37,123	1.97	0.17
Kandal	1045	18	4,816	15,723	28,527	3.84	0.10
Kampong Cham	1575	12	4,277	12,504	23,110	4.26	0.07
Battambang	752	26	5,828	19,880	39,879	2.33	0.09
Prey Veng	929	53	4,758	14,987	27,003	4.83	0.15
Siem Reap	664	54	5,343	11,392	27,552	2.82	0.05
Kampong Thom	547	29	5,280	14,256	32,806	3.29	0.14
Takeo	775	15	4,498	16,526	30,152	3.66	0.09
Svay Rieng	472	43	5,319	14,648	31,436	3.80	0.08
Pursat	344	41	5,612	15,549	40,628	2.99	0.16
Kampong Chhnang	403	45	5,755	14,691	36,336	2.79	0.14
Kampong Speu	579	18	4,911	13,750	30,824	3.25	0.09
Kampot	521	19	6,086	14,657	35,073	3.05	0.09
Krong Preah Sihanouk	148	34	7,846	17,481	53,271	2.32	0.16
Koh Kong	106	8	8,570	10,947	49,463	3.77	0.51
Preah Vihear	113	29	8,979	15,024	52,035	4.58	0.30
Kracheh	253	39	7,718	15,961	38,318	4.01	0.19
Ratanakiri	92	9	12,569	14,227	60,754	3.97	0.75
Mondol Kiri	31	20	17,045	28,859	124,037	3.45	0.99
Banteay Mean Chey	560	41	5,532	12,566	29,740	3.20	0.11
Stueng Treng	77	16	15,784	20,997	80,740	3.37	0.43
Krong Keb	20	49	20,325	58,943	213,415	4.35	0.86
Pailin	6	97	73,713	103,101	678,357	3.70	0.78
Otdar Mean Chey	63	39	10,493	18,884	87,810	3.32	0.16
Total	10,995	28	5,315	15,189	33,610	3.33	0.12

Source: MEF budget data.

6.42 For the time being, key services, such as education, health and infrastructure, will continue to be managed by the provincial administrations of central agencies and receive their resources through the state budget. While the creation of the communes provides an opportunity for local initiatives and a framework for coordination of development efforts at the field level, they will not have a significant impact on the structure of spending. In this context,

further deconcentration of sector budgets and the expansion of streamlined budget execution mechanisms, such as PAP, are critical if additional resources are to be mobilized for service delivery. At the same time, improvements in resource targeting are needed so that the poorer provinces and those with lower than average service coverage, benefit from a larger share of resources.

6.43 Responsibility for the formulation and execution of sector budgets is divided between central ministries and their provincial departments. Ministries allocate the budget ceiling between their central agency and their provincial delegations in consultation with the MEF's DBFA. For the most part, the provincial department's ceiling is determined incrementally, taking into account increases in staffing levels, with little adjustment in the regional structure from year to year. Provincial administration budgets are then prepared in conjunction with the Provincial Departments of Finance (PDAFs). Provincial budgets are compiled, executed, and monitored separately by the DBFA's provincial budget unit. At the beginning of each year, the line ministers delegate their authority as financial officers to the respective provincial governors, who are appointed by the King on the advice of the OPM. Consequently, while governors may intervene informally at the formulation stage, they have formal authority during budget execution. As all the players know that governors have an impact on actual budget execution, it is likely that gubernatorial influence extends back into the formulation stage, as it is in the interest of line ministries to negotiate agreements during formulation.

6.44 The logic of the present system is to balance central agencies' policy and technical leadership with the need to adapt to local conditions. However, the lack of clarity regarding the relative competencies of provincial governors and ministries under the system of dual subordination, as well as poor communications with the capital, tends to undermine coordination between provinces and central agencies during the budget process. Since funding for budget execution is released by PDAFs, rather than the central agency, scarce cash is allocated on the basis of locally-defined priorities, leaving priority sectors starved of resources in some cases. This undermines the rationale for targeted budget support to the Government's priority sectors through conventional mechanisms, since there is no guarantee that allocations for the priority sectors will actually be implemented at the provincial level. It also makes it difficult for central agencies to hold their provincial delegations accountable for performance, since the resources needed to implement agreed programs may not be made available.

6.45 The problem in education and most other sectors is that provincial spending, which accounts for a large share of total spending, might not be as tightly aligned with sectoral policy priorities. Nor is provincial spending as targeted to pro-poor service delivery as it ought to be (see Chapter 3). Two different approaches are being piloted in education and health to address the problem of technical inefficiency with respect to geographic resource allocation (see Box 6.1). Given the current state of centralization in Cambodia, it does not make sense for provincial budgets to be divorced from sectoral planning and budgeting processes. Improving technical efficiency in resource allocation will necessarily require better integration of provincial and central planning and budgeting.

6.46 The technical solution to these problems is to clarify the competencies of different levels of administration. The PBL went some way toward this by assigning provinces and municipalities exclusive competence for local services, including local roads, municipal services, and their offices. However, a formal division of competencies in other areas, such as education and health, would require policy decisions on the appropriate degree of cross-governmental decentralization that are likely to take many years to resolve.

6.47 In the meantime, progress is best achieved at a sectoral level. Introduction of PAP has enabled the health and education sectors to channel funds directly to provincial administrations,

by-passing the provincial budget execution system. Health has also made arrangements to earmark funding for provincial health delegations under the conventional budget mechanism. Similar arrangements could be made, administratively, for the remaining priority sectors. This would allow MEF and sector agencies to set targets for and monitor the deconcentration of resources. Sector earmarking at the provincial level would also allow line agencies to improve targeting of spending, by applying allocational formula based on indicators of need and/or performance.

Box 6.1: Improving Geographical Targeting in Health and Education

In the health sector, funds for operations, drugs, and supplies under Chapter 11 & 13 are allocated between provinces on a formula basis. Fixed allocations are assigned to district health offices, district referral hospitals, and health centers. Provincial health offices receive a percentage mark-up based on total operational district (OD) funding, and specific activities are allocated funds according to the number of patients using historical data. These criteria determine the block allocation for each province and OD. It is important to note, however, that facilities in individual provinces do not necessarily receive these allocations and are dependent on the budget management of each OD office, and that resources to individual operational districts within a province are often divided up on the basis of a local agreement.

The advantage of this formula-based approach to resource allocation is that it is clear and easily understandable. It also implicitly recognizes that many of the costs associated with health care provision are fixed and are incurred in sparsely populated areas to almost the same extent as in areas with large populations. However, the problem is that allocations are not strongly related to the quantity of health care need as measured by either the size of the population or health status indicators.

There are two main ways of addressing this issue. The first is to ensure that the distribution of physical facilities better matches the needs and size of a population in a particular area. In fact the historic mismatch between population and facilities is gradually being addressed through the 1996 health coverage plan, the recent sector strategy and supporting infrastructure development financed by government and external funding agencies. In principle, if facilities are equally distributed standardized recurrent allocations can then be allocated to each facility. The problem is that needs vary across populations of similar size and also fluctuate over time. Basing recurrent allocations on physical infrastructure may not be sufficiently responsive to these changes. A second approach is to ensure that physical infrastructure is as equitably distributed as possible but then allocate recurrent funding mainly on the basis of population weighted for other need factors such as cost and health status.

Education MOEYS has made sure that PAP (Chapter 13) is derived from the estimated recurrent cost of the priority programs in the rolling ESSP. The PAP chapter is prepared by MOEYS at the central level and there is a strong alignment between the education sector objectives and Chapter 13 budget allocations. Breakdowns by priority programs, and program allocations by Budget Management Centers (BMCs) and individual schools are made. Once the budget is approved, each BMC implements its program. The PAP has introduced allocations to line managers and increased the programmatic transparency of budget allocations. The budget information is widely available to all managers in the MOEYS and the donor community (although less so at the district and school levels).

Although the ESSP estimates the capital and recurrent expenditure requirements to achieve the ESP objectives, linkages between the budgeting for Chapter 13 (PAP) and other budget chapters are not strong and they overlap. The problems with the capital budget have already been discussed. In addition, however, there is no link between the ESP objectives and the budgeting of Chapters 11 and 31. In the ESP cost estimates, a certain percentage increase in these chapters is assumed. However, linkages are not made between these expenditures and the strategies and targeted outcomes of the ESP/ESSP. PAP, as opposed to the other budget lines, seems to have a much greater responsiveness to sector priorities at both the central and provincial levels. PAP has clearly had a positive impact on the budget formulation process in the education sector.

Recommendations

- Develop a framework for deconcentration based on further analytical work and clarity of reform objectives.

- Allow sector earmarking of some provincial expenditures to improve pro-poor targeting by applying an allocational formula based on indicators of need and/or performance.

KEY OPPORTUNITIES AND CHALLENGES IN MOVING FORWARD : STRATEGY, CAPACITY BUILDING AND IMPLEMENTATION

6.48 Perhaps the greatest potential problems with the development and implementation of decentralization and deconcentration lie in the lack of attention to the coordinated development of a clear vision of where the system should be heading. Part of the problem is that CAR has primary responsibility for deconcentration, while NCSC (chaired by MOI) takes the lead on decentralization. International experience suggests that such fragmentation of responsibility inevitably leads to conflicts and policy inconsistencies. Deconcentration and decentralization are closely linked, and this is best reflected in an overarching and empowered coordination mechanism. Closer formal links between CAR and NCSC—which might take the form of a joint work program with key milestones for joint review—are highly desirable.

6.49 A related issue is the extent to which commune, provincial, and national planning are integrated effectively in pursuit of the NPRS. Provincial and Commune Development Plans (PDP and CDP) necessarily have their own identity. PDPs are part of the national planning system and focus on the provincial attainment of national goals. The CDPs represent local priorities expressed through elected councils. This does not mean that national priorities are irrelevant for CDPs, but there must be some independence of development plans of different levels in a multi-level government system. Despite their separate identities, PDPs and CDPs are inescapably linked (e.g., Seila provinces have held planning integration workshops to provide an opportunity for provincial/district and commune representative to review and maximize the consistency of their development activities). Communes can also pass to provinces requests for priority services beyond their authority, means, or capacity. Similar planning integration, with appropriate modification, will be needed in the evolving RGC system, and this should extend to budgets. Presently provincial (gubernatorial) budgets barely cover basic operating expenses, so that provinces have little budgetary flexibility. As deconcentration proceeds, closer coordination of provincial and commune budgets will make more sense (with the caveat that they should remain legally separate).

6.50 The problem of capacity at all levels remains a great challenge to designing and implementing decentralization and deconcentration reforms. Provincial staff need skills for their own functions as well as to support the commune system. The commune councils and staff, including counselors, sub-committee members, and clerks, must also be trained to meet their obligations. The costs of capacity building and technical assistance are likely to be enormous.¹¹⁹ Further work is needed to establish the reliability of these estimates, to determine their implication for the implementation strategy, and to create a credible basis for securing additional donor resources.

6.51 At the provincial level, RGC plans for the decentralization support structure are not completely clear. Provincial Rural Development Committees (PRDCs) will continue to coordinate commune capacity building and technical assistance. However, the longer term role of the PRDCs is far from clear in light of the newly created Provincial Offices of Local Administration (POLAs), which have been created as the main interface between provinces and communes. Institutional restructuring based on clear functional allocations of responsibilities is

¹¹⁹ It was recently estimated that over the period 2002-2005, US\$ 6 million will be required for national program support for decentralization, about \$15 million for provincial program support for the communes, and about \$4.5 million for commune level capacity building and public education on decentralization. Of this total of \$25.5 million, approximately \$13.5 million is yet to be covered by either domestic contributions or committed external resources. In addition, the RGC estimates that \$13 million is required for basic commune office facilities and equipment.

an important part of broader public sector reform, given the scarcity of resources and the need to maintain a right-sized civil service.

6.52 Related to concerns about integration of reforms and structures is the role of the villages. Although not elected levels of government, villages are an important link to local people and are expected to play a role in development planning. The RGC is still considering how to deal with villages in the context of the rural development institutional structure. It appears that Village Development Committees (VDCs) will continue to exist where they have already been created, but it is not clear that new ones will be developed. The decentralization regulations allow commune councils to appoint a village chief and the village chief to appoint deputies, raising concerns about whether people appointed in this way will feel accountable to villagers. Clarification of the role of villages and development of a joint position by MRD and MOI are necessary.

6.53 Lastly, bolstering and safeguarding the democratic integrity of the commune system is an important challenge for the Government. The councils in principle have a fair degree of autonomy provided they satisfy certain legal requirements. There is, however, considerable potential for interference. The only technical staff person at the commune level, the clerk, is an employee of MOI, and the role of council accountant is played by a staff member of the PT. In addition, many communes will for the foreseeable future be dependent on technical assistance from provincial sectoral departments. Finally, governors have substantial commune oversight powers. Given the hierarchical mentality prevailing in the civil service and the institutional weaknesses in the system, even with defined legal safeguards and the very best of intentions, there are ample opportunities for interference in commune affairs. Higher-level oversight is clearly appropriate, but care must be taken to balance the vertical accountability of the councils with their accountability to the people who elected them. Existing legal provisions do this to some extent, but whether the rules can be enforced is less clear. This is a delicate and complex matter in practice and requires careful consideration and monitoring.

Recommendations

- Undertake further work to improve the reliability of capacity building requirement costs, to determine implications for the implementation strategy, and to create a credible basis for securing additional donor resources.
- Rationalize strategy for institutional support of communes, clarifying division of labor between PRDCs and POLAs as necessary.
- Clarify and develop a joint MRD/MOI position on the role of villages.

7. CONCLUSION: TOWARD A STRATEGY OF REFORM

7.1 This review has argued that Cambodia has to meet a number of key challenges—fiscal, fiduciary, and institutional—over the medium term if it is to make significant progress on its poverty reduction and development plan. First, Cambodia will have to improve resource mobilization to ensure aggregate fiscal sustainability. Second, to reduce fiduciary risk to public funds, the Government will have to engage in comprehensive reform of budget execution, cash management, and public financial control systems. Third, the Government will have to rationalize public expenditure policy and management further to carry out its National Poverty Reduction Strategy (NPRS). Last, Cambodia will have need to undertake comprehensive civil service reform—focusing on pay and employment issues—in order to deliver poverty-reducing services.

7.2 In broad terms the fiscal, fiduciary, and institutional challenges identified in this review have been on the Government’s reform agenda for some time. To place this analysis in context, this brief section assesses progress made to date in implementing the recommendations of the 1999 World Bank Public Expenditure Review (PER), based on the premise that understanding progress as well as obstacles to progress may shed some light on how to craft a reform strategy (see Annex C. *Cambodia 1999 PER—Summary of Achievement*).

7.3 There is no doubt that the Government has made progress—significant in some areas, less impressive in others—in all major reform areas flagged by the World Bank’s 1999 PER: domestic resource mobilization, rationalizing public expenditure policy, and enhancing public expenditure management.¹²⁰ The most notable areas of progress are those in which central oversight agencies and line ministries partnered to implement reform. The best example of this is the Priority Action Program in education and health, which has moved line agencies toward program budgeting, improved the targeting of resources to the poor, and may also have had a positive impact on outcomes. To be sure, further improvement is required, but there has been progress. Less impressive progress has been made in forestry, for example, where reform seemed to proceed well to the point of policy but floundered when it came to implementation. Other reforms in the areas of civil service and tax policy and administration fall between the two extremes. The Government undertook some civil service reform, but overall progress has been too slow, relative to the importance of the problem. On tax policy and administration there was some progress in revising the Law on Investment and strengthening tax administration, but many would argue that measures fell short of resolving the core problems.

7.4 One factor which may explain the differential in success is the level of consensus about the importance and nature of the reform. On PAP there was broad agreement between the Government (central and line ministries) and the donors that getting resources to the front line of service delivery was crucial. On civil service reform there was not such agreement between either central and line agencies or between Government and donors on the nature of the reform needed. In the area of tax policy there was also less consensus between Government and donors. For example, there were legitimate differences of opinion about the benefits of tax incentives. It

¹²⁰ It should be pointed out that the 1999 PER is used to ground this brief assessment, though it is understood that many other donors (including the IMF, ADB, UNDP, and the bilaterals), documents (including the SEDP and SEDP II), and instruments (including the PRGF, SAC, and other project and program loans) are integral parts of the reform process.

seems that to the extent that technical issues are unresolved in a convincing manner, reform will be undermined. Another factor that might explain success in the case of PAP is the relative simplicity—at least at the conceptual level—of the reform itself, which was especially important given weak bureaucratic capacity. This suggests the critical importance of building technical consensus as a foundation for reform, and of keeping reform simple.

7.5 Forging consensus means taking a participatory approach to analysis and problem solving, as in the case of this review. For example, Government, the Bank, the ADB, and others donors, notably the IMF, DFID, and SIDA, participated in reviewing the concept paper, the terms of reference for individual studies, and the subsequent drafts of individual sections (some also provided financial support). Several workshops were also held to facilitate discussion between Government and donors, and within Government (some line agencies seemed to place great value on the workshop sessions in which they could communicate directly with central oversight ministries). More, however, remains to be done. First, donors themselves should take greater responsibility for coming to consensus. A review such as this offers the donor community the chance to explore options and arrive at consensus. Fragmentation in the donor community reduces the probability of reform. The Government itself needs to do more to forge consensus between central oversight (e.g., CAR and MEF) and the line agencies. This includes improving the sharing of information between agencies, and with donors.

7.6 The second hypothesis—that the Government tends to rely on ad hoc reform approaches for systemic problems—reflects the weak capacity of the public sector to undertake change, which has been noted throughout this review. The principal examples of the ad hoc approach are the Priority Action Program—as a parallel budget system operating in a small set of ministries—and the Priority Mission Group program—as a parallel salary system in which relatively high salary supplements are provided to small groups of individuals working on priority tasks. The limited existing capacity makes these types of approaches inevitable. They are not without their potential costs, however. The first potential cost is that these ad hoc approaches are not embedded in long term reform strategies. To the extent that these measures become isolated from the bigger reform picture, instead of paving the way toward more comprehensive reform, they could ultimately undermine or postpone systemic reform. Paradoxically, the more successful these ad hoc measures are in solving critical problems, the less urgent systemic reform becomes. The second potential cost is that these limited reforms drain existing capacity from more comprehensive reform.

7.7 The suggested solution, then, is to make sure that ad hoc measures are part of a larger reform program. This is now what the Government, together with donor partners, is developing for PAP. This review, for example, suggests a reform strategy for mainstreaming PAP and consolidating the different budget systems. Ideally, ad hoc measures would be part of a comprehensive and sequenced reform strategy from the start. The strategy would then be updated periodically to reflect recent experience. If, for example, the Government decides to move forward with a semi-autonomous revenue authority, it should make sure that the reform should be embedded in a larger medium term tax reform strategy.

7.8 Though the IFAPER focuses more on institutional issues—public expenditure and financial management, the civil service, and decentralization—the broad themes identified in the IFAPER and the 1999 PER are consistent. This is not surprising, since weak capacity means that reforms will have to be gradual. It does mean, however, that to be most useful to the Government, donors will have to assist in the development of strategies to overcome institutional obstacles, which entails participatory approaches and consensus building. Ultimately, this review will only be successful to the extent that it builds on the existing participatory process as donors move forward to support Government in implementing this set of recommendations.

7.9 **The analysis suggests three guidelines for moving forward with a public expenditure policy and management reform agenda.** First, donors and Government should continue the participatory approach with which this review began. Donor-donor and Government-donor consensus is critical for ensuring success, and a premium should be put on negotiated consensus. Second, any ad hoc or pilot reform measures must be placed, from the outset, in the context of a broad reform strategy. Third, reforms must be simple—and tailored to bureaucratic constraints and political incentives. Greater attention to the politico-bureaucratic context of technical reforms should enable reformers to craft measures more likely to be successful.

ANNEX A

Table A1 Cambodia: Medium-Term Macroeconomic Framework
(in percent of GDP, unless otherwise indicated; based on the 2002 National Accounts)

	1999	2000	2001	2002	2003	2004	2005	2006	2007
	Projections								
Real Sector									
Real GDP (percent change)	6.9	7.7	6.3	4.5	5.0	6.0	6.0	6.3	6.5
Real Per capita GDP (in CR, percentage change)	4.2	5.0	3.7	2.5	2.9	3.9	2.9	3.2	3.4
CPI Inflation (average: percentage change)	4.0	-0.8	0.2	3.3	3.8	3.5	3.5	3.5	3.5
National saving	13.6	9.2	12.7	13.7	13.9	14.1	14.1	14.4	14.6
Government saving	1.6	1.5	1.2	0.9	1.1	1.3	1.3	1.3	1.2
Private saving	12.0	7.7	11.5	12.8	12.8	12.8	12.8	13.1	13.5
Domestic investment	15.9	13.5	17.9	16.6	16.9	17.4	17.7	17.8	18.0
Government investment	5.7	6.7	7.2	7.7	7.1	7.0	6.9	6.8	6.8
Private investment	10.2	6.8	10.7	8.9	9.8	10.4	10.8	11.0	11.2
Of which: change in inventories	1.4	-1.7	2.0	--	--	--	--	--	--
Fiscal Sector									
Revenue	10.6	11.2	11.7	12.1	12.7	13.4	13.9	14.3	14.5
Tax revenue	7.7	8.2	8.4	8.5	8.5	8.7	8.8	8.8	8.6
Of which: Domestic Taxes	1.1	1.8	1.8	1.9	1.8	1.8	1.8	1.8	1.8
Int. Taxes	6.3	6.2	6.3	6.5	6.6	6.8	6.8	6.8	6.7
Nontax revenue	2.8	2.8	3.2	3.5	3.6	3.6	3.4	3.5	3.6
Of which: quota auctions	0.7	0.2	0.3	0.4	0.5	0.5	0.0	0.0	0.0
Capital Revenue	0.1	0.2	0.1	0.1	0.2	0.2	0.3	0.3	0.3
Revenue Measures	--	--	--	--	0.4	0.8	1.4	1.7	2.0
Expenditure (cash basis)	14.7	16.4	17.7	18.9	19.0	19.1	19.4	19.7	20.2
Current	8.9	9.5	10.4	11.1	11.4	11.9	12.2	12.6	13.1
Interest payments	0.1	0.1	0.2	0.2	0.5	0.7	0.7	0.7	0.7
Other	4.6	5.4	6.6	7.0	7.0	7.1	7.2	7.5	7.8
Memo item: social spending ^{1/}	2.0	2.3	2.9	3.6	3.8	4.3	4.4	4.5	4.5
Capital	5.8	6.9	7.3	7.8	7.3	7.2	7.1	7.1	7.1
Current balance	1.6	1.5	1.2	0.9	1.1	1.3	1.3	1.3	1.2
Overall balance	-4.0	-5.2	-6.0	-6.8	-6.3	-5.7	-5.5	-5.5	-5.6
Overall balance (including grants)	-1.3	-2.3	-3.1	-3.3	-3.4	-2.9	-2.7	-2.6	-2.8
Domestic financing	-0.3	-0.1	0.1	-0.3	-0.2	0.0	0.0	0.0	0.0
External financing ^{2/}	4.4	5.3	5.9	7.1	6.5	5.7	5.5	5.5	5.5
Disbursements	4.4	5.3	6.0	7.2	6.8	6.0	6.0	6.0	6.0
Amortizations	0.0	0.0	0.0	0.1	0.3	0.3	0.5	0.5	0.5
External Sector									
Domestic exports (percentage change)	34.5	30.9	7.4	10.7	9.6	9.7	10.9	10.3	10.5
Retained imports (percentage change)	27.7	36.5	6.8	5.8	8.6	9.8	9.8	9.9	10.1
Retained imports (excl. garments, pct. change)	16.8	29.8	3.8	6.6	9.2	12.3	12.1	11.9	12.1
Current account balance (excluding transfers)	-9.0	-12.3	-13.4	-10.7	-10.4	-10.5	-10.8	-10.4	-10.0
Current account balance (including transfers)	-2.3	-4.3	-5.3	-2.9	-3.0	-3.3	-3.6	-3.4	-3.4
Foreign direct inv. (in millions of US\$)	146	135	95	98	101	110	120	131	144
Overall balance	-2.8	-1.7	0.6	1.4	0.4	0.4	0.9	1.8	2.0
Gross official reserves (in millions of US\$)	422	485	550	642	696	742	810	904	1,011
(in months of imports of goods & services)	3.2	2.8	2.9	3.3	3.3	3.2	3.2	3.3	3.4
Net capital flows ^{3/}	8.5	10.8	11.9	10.6	11.4	10.2	10.1	10.1	9.6
Financing gap (in millions of US\$)	0	0	0	0	31	20	15	0	1
External debt ^{4/}	68.7	67.6	66.2	65.6	35.2	36.0	37.0	38.3	39.4
External debt (NPV) ^{4/}	56.1	56.0	55.5	52.9	21.8	22.0	22.2	23.0	21.6
External publ. debt-serv. ratio, accrual basis ^{5/}	11.1	8.5	3.3	3.0	2.6	2.6	2.4	2.2	2.3
External publ. debt-serv. Ratio, cash basis ^{6/}	0.7	0.8	1.1	1.1	2.1	2.6	2.4	2.2	2.3

Sources: Data provided by Cambodian authorities and Fund staff estimates and projections.

^{1/} Includes components of wages paid in the social sectors.

^{2/} Includes disbursements for the financing gap in 2003.

^{3/} Net official disbursement, exceptional financing and official transfers.

^{4/} Figures include bilateral debt with the Russian Federation and the United States and reflects the impact of completing rescheduling agreements on Naples terms with these creditors in mid 2003.

^{5/} As percent of domestic exports of goods and services. The declines in 2000 and 2001 reflect the tailing off of payments to the Russian Federation.

^{6/} As percent of domestic exports of goods and services.

Table A2. Public Expenditure Cambodia and International Comparators, % GDP

Comparators	Total	Health	Education
East Asia & Pacific	15.0-	1.8	4.0
South Asia	16.7	1.2	3.0
Low Income	18.4	1.2	3.8
Vietnam	21.2	1.0	2.8
Lao PDR		2.3	2.4
Cambodia, incl. External	25.3	2.9	3.0
Cambodia, Government only	12.8	1.0	1.7

Source: World Development Indicators, 2002.

Table A3. Treasury-Executed Spending by Function, % Structure

Function	1996	1997	1998	1999	2000	2001	2002E	2003B
Core Government	62.6	63.2	69.4	54.7	58.9	51.0	41.0	37.4
General Administration	17.0	15.7	26.0	19.0	29.1	25.7	18.7	17.5
Defense	32.5	32.7	29.5	25.2	20.2	16.5	14.2	12.6
Security	12.8	14.6	13.7	10.1	9.3	8.5	7.6	6.8
Judiciary	0.3	0.3	0.2	0.3	0.4	0.4	0.5	0.5
Economic Services	10.8	14.1	9.3	14.2	12.6	16.9	8.3	8.0
Agriculture	2.1	2.6	1.7	1.9	2.3	3.9	3.0	2.7
Transport	3.1	4.1	1.8	2.6	5.1	6.4	1.1	1.0
Public Works	2.6	2.6	1.2	2.2	4.7	5.4	0.8	0.7
Other transport	0.5	1.5	0.5	0.4	0.4	1.0	0.3	0.3
Other Economic Services	5.5	7.3	5.7	9.5	4.8	6.1	3.9	3.8
Environmental Protection	0.2	0.2	0.1	0.2	0.3	0.4	0.4	0.4
Rural Development	0.5	0.4	0.6	1.2	0.8	1.8	1.1	1.0
Social Services	19.5	21.2	18.8	26.4	24.8	28.1	31.8	30.2
Health	4.8	5.9	4.2	9.4	6.7	7.9	9.4	9.5
Recreation, Culture & Religion	0.6	0.8	0.6	0.8	1.8	1.9	1.4	1.4
Education	9.1	9.1	9.4	11.4	10.7	12.9	15.8	14.6
Social Protection	5.0	5.5	4.6	4.8	5.7	5.4	5.3	4.7
Other	6.5	1.0	1.9	3.5	2.9	2.2	17.8	23.5
Debt	6.5	1.0	1.9	2.5	2.0	1.8	1.3	2.5
Other not classified	-	-	-	1.1	0.9	0.5	16.4	21.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: MEF TOFE Reports.

Table A4: Treasury-Executed Civil Administration Expenditure by Economic Category, as % of GDP

Budget Chapter	1996	1997	1998	1999	2000	2001	2002E	2003B
Sub-Total Current Expenditure	4.6	4.3	4.2	5.0	5.9	7.4	8.2	8.6
10: Salaries and Allowances	1.5	1.5	1.3	1.5	1.7	1.7	2.2	2.1
11: Operating Costs	1.9	1.8	1.7	2.1	2.8	3.5	3.2	3.0
12: Subsidies for Prov. Admin.	0.2	0.2	0.1	0.1	0.2	0.2	0.4	0.7
13: Special Prog. Agreements	0.0	0.0	0.3	0.0	0.1	0.6	1.0	1.0
20: Interest on Loans	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2
30: Econ. Transfer Payments	0.2	0.1	0.1	0.1	0.2	0.3	0.3	0.2
31: Social Transfer Payments	0.6	0.7	0.5	0.7	0.7	0.9	0.8	0.7
32: Transfer to Int. Org.	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1
40: Miscellaneous	-	0.0	-	0.1	0.1	0.1	0.1	0.6
41: Contingencies	-	-	-	-	-	-	-	0.1
Sub-total Capital Expenditures	1.3	1.0	1.1	1.8	2.4	2.2	2.0	2.3
50.1: Cons. & Equipment	0.6	0.8	0.7	1.5	1.7	1.4	1.5	0.9
50.2: Counterpart Funds	0.1	0.2	0.3	0.2	0.6	0.4	0.4	0.4
50.3: Inv. by Foreign Funds	-	-	-	-	-	0.3	0.1	0.8
52: Financial Operations	-	0.0	-	-	-	-	-	-
53: Debt Amortization	0.5	0.1	0.0	0.1	0.1	0.1	-	0.2
Total	5.9	5.4	5.3	6.8	8.3	9.6	10.2	10.9

Source: MEF TOFE Reports and Bank estimates.

Table A5: Ratio of Operating Expenditures to Salaries and Allowances by Function

Function	1996	1997	1998	1999	2000	2001	2002E	2003B
Core Government	1.67	1.94	3.01	2.57	3.21	4.32	2.52	1.99
General Administration	1.67	1.93	3.05	2.54	3.19	4.32	2.52	1.97
Judiciary	1.71	2.22	1.26	3.73	4.02	4.29	2.53	2.59
Economic Services	2.78	2.35	2.44	3.26	3.02	4.03	2.87	3.37
Agriculture	1.53	1.07	1.15	1.67	2.15	3.23	2.52	2.78
Transport	0.54	0.53	0.42	0.84	0.92	1.24	0.92	1.49
Public Works	0.41	0.34	0.28	0.84	0.95	1.30	0.96	1.22
Other transport	0.94	1.10	0.80	0.81	0.85	1.14	0.84	2.21
Other Economic Services	7.10	6.48	6.69	8.62	6.71	7.22	5.03	5.43
Environmental Protection	2.91	1.73	1.50	1.84	2.40	4.62	2.54	2.88
Rural Development	1.43	1.12	1.19	1.54	4.25	7.35	6.63	6.56
Social Services	0.80	0.69	0.58	0.80	0.99	1.36	1.47	1.50
Health	3.63	3.28	3.10	5.15	6.34	8.31	6.20	6.20
Recreation, Culture & Religion	0.78	0.99	0.75	1.34	2.58	2.92	2.79	3.29
Education	0.34	0.24	0.23	0.30	0.29	0.53	0.71	0.70
Social Protection	1.44	1.29	0.77	1.49	2.36	3.59	3.04	3.09
Total	1.29	1.24	1.42	1.44	1.73	2.36	1.91	1.85

Source: MEF TOFE Reports and Bank estimates.

Table A6: External Assistance as Percentage of Total Sector Expenditure

Summary Function	1996	1997	1998	1999	2000	2001
Core Government	19.8	23.3	20.8	9.2	7.8	9.0
Economic Services	37.5	27.6	25.9	26.2	27.0	24.6
Agriculture	14.5	4.8	2.9	6.8	10.3	8.3
Transport	13.5	10.0	11.0	9.1	11.0	14.0
Other Economic Services	8.7	11.2	11.1	9.5	5.2	2.0
Environmental Protection	0.8	1.6	0.8	0.8	0.5	0.2
Area/Rural Development	17.6	18.2	14.8	15.6	15.7	14.5
Social Services	22.3	26.6	36.2	36.5	33.8	42.5
Health	9.8	8.6	14.8	19.0	15.8	15.5
Education	7.8	13.0	13.7	10.8	9.5	10.6
Community & Social Services	4.7	5.1	7.8	6.6	8.5	16.4
Humanitarian Aid & Relief	2.8	4.3	2.3	12.7	15.6	9.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank estimates based on CDC Database and MEF TOFE.

Table A7: Treasury-Executed Civil Administration Expenditure by Economic Category, as % of GDP

Function	1996	1997	1998	1999	2000	2001	2002E	2003B
Core Government	1.67	1.94	3.01	2.57	3.21	4.32	2.52	1.99
General Administration	1.67	1.93	3.05	2.54	3.19	4.32	2.52	1.97
Judiciary	1.71	2.22	1.26	3.73	4.02	4.29	2.53	2.59
Economic Services	2.78	2.35	2.44	3.26	3.02	4.03	2.87	3.37
Agriculture	1.53	1.07	1.15	1.67	2.15	3.23	2.52	2.78
Transport	0.54	0.53	0.42	0.84	0.92	1.24	0.92	1.49
Public Works	0.41	0.34	0.28	0.84	0.95	1.30	0.96	1.22
Other transport	0.94	1.10	0.80	0.81	0.85	1.14	0.84	2.21
Other Economic Services	7.10	6.48	6.69	8.62	6.71	7.22	5.03	5.43
Environmental Protection	2.91	1.73	1.50	1.84	2.40	4.62	2.54	2.88
Rural Development	1.43	1.12	1.19	1.54	4.25	7.35	6.63	6.56
Social Services	0.80	0.69	0.58	0.80	0.99	1.36	1.47	1.50
Health	3.63	3.28	3.10	5.15	6.34	8.31	6.20	6.20
Recreation, Culture & Religion	0.78	0.99	0.75	1.34	2.58	2.92	2.79	3.29
Education	0.34	0.24	0.23	0.30	0.29	0.53	0.71	0.70
Social Protection	1.44	1.29	0.77	1.49	2.36	3.59	3.04	3.09
Total	1.29	1.24	1.42	1.44	1.73	2.36	1.91	1.85

Source: MEF TOFE Reports and Bank estimates.

Table A8: Civil Servants by Ministry and Location, 2001-2003 ^{a/}

Ministry	2001				2002				2003			
	Total	Central	Province	Total	Central	Province	Total	Central	Total	Central	Province	Province
Public Works and Transportation	5,169	2,029	3,140	4,818	1,911	2,907	4,594	1,854	2,740			
Justice	1,321	560	761	1,268	541	727	1,221	472	749			
Tourism	967	502	465	963	482	481	921	458	463			
Land Planning, Urban. & Construct.	2,485	641	1,844	2,483	657	1,826	2,372	597	1,775			
Water Resources and Meteorology	1,899	1,088	811	1,864	1,034	830	2,021	1,214	807			
National Election Committee	237	237		254	254		259	259				
National Audit Authority							188	188				
Culture and Art	3,610	1,827	1,783	3,377	1,721	1,656	3,316	1,727	1,589			
Environment	1,694	867	827	1,838	1,038	800	1,892	1,051	841			
Rural Development	2,371	633	1,738	2,327	650	1,677	2,284	654	1,630			
Social Affairs, Labor and Youth Rehab.	1,859	765	1,094	1,849	788	1,061	1,852	804	1,048			
Post and Telecommunications	2,186	1,497	689	1,999	1,339	660	2,048	1,432	616			
Cult and Religion	677	257	420	685	275	410	683	300	383			
Women's and Veterans Affairs	1,446	310	1,136	1,382	296	1,086	1,358	297	1,061			
Information	2,469	1,368	1,101	2,326	1,248	1,078	2,276	1,234	1,042			
Health	18,171	4,092	14,079	18,275	4,131	14,144	17,530	4,050	13,480			
Industry, Mines and Energy	2,195	751	1,444	2,091	723	1,368	1,965	698	1,267			
Planning	1,727	631	1,096	1,621	586	1,035	1,555	576	979			
Commerce	2,359	1,518	841	2,116	1,246	870	2,248	1,477	771			
Education, Youth and Sports	81,664	3,351	78,313	84,036	2,541	81,495	85,070	2,565	82,505			
Agriculture, Forestry and Fisheries	9,933	4,201	5,732	9,415	3,922	5,493	9,132	3,848	5,284			
Royal Palace	290	290		301	301		311	311				
National Assembly	618	618		680	680		900	900				
Senate	404	404		472	472		451	451				
Constitutional Council	95	95		102	102		108	108				
Council of Ministers	2,083	2,083		2,129	2,129		2,347	2,347				
Interior	9,963	4,73	9,490	9,115	441	8,674	12,638	2,147	10,491			
Parl. & Senate Relations and Insp.	346	346		321	321		330	330				
Foreign Affairs and Intl. Coop.	799	799		908	908		780	780				
Economy and Finance	5,360	4,335	1,025	5,204	4,250	954	5,150	4,232	918			
Total	164,397	36,568	127,829	164,219	34,987	129,232	167,800	37,361	130,439			

Source: Budget laws.

^{a/} Includes political appointees (ministers and their advisors) and others (personnel on term contracts, "floating," and on leave without pay). Political appointees numbered 906 in 2003, while others totaled 8,867.

Table A9. Country Comparisons of Education Indicators and Expenditure

	Student: Teacher Ratios				% of Primary Repeaters Cohort Reaching Grade 5				Govt. Expenditure On Education				Budget Shares				Per Student Expenditure As % of GDP per capita												
	Primary		Secondary		Primary		Secondary		% GNP		% Govt. Exp		Primary		Secondary		Tertiary		Primary		Secondary		Tertiary						
	57	22	10	50	94	100	89	16	24	31	30	20	19	15	36	21	22	32	35	29.7	11.4	19	13	61	54	53	-	27	88
Cambodia	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
China	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Hong Kong	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Indonesia	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Japan	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Korea, Rep	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Lao PDR	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Malaysia	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Mongolia	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Philippines	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Thailand	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Vietnam	24	20	18	16	24	53	99	100	-	-	8	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Note: Data are for the most recent year, generally between 1997-1999, with the exception of Cambodia which is for 2001/02.

Sources: World Bank Edstats; UNESCO 1999 yearbook. Mongolia – Public Expenditure and Financial Management Review, World Bank.

Table A10. Total Government and External Expenditure on Education

(CR millions)

	1997	1998	1999	2000	2001	2002	2003
1-General Education	9,312	10,055	26,564	26,736	47,470	94,210	110,700
<i>Recurrent</i>	7,002	9,912	20,613	22,691	31,117	94,210	110,700
Ch 10 Wage	1,621	1,849	1,991	2,202	1,229	1,450	2,140
PAP Wage				-	-	10,752	12,400
Non Wage	5,381	8,063	18,622	20,489	29,888	82,008	96,160
O&M	4,605	7,866	18,486	20,291	17,551	22,300	24,420
PAP	-	-	-	144	12,163	59,383	71,300
Subsidies	776	197	136	54	174	325	440
<i>Capital</i>	2,310	143	5,951	4,045	16,353	-	-
2-Higher Education	4,362	5,156	8,550	9,001	11,732	15,000	18,768
<i>Recurrent</i>	4,011	4,986	8,550	9,001	11,732	15,000	18,768
Ch 10 Wage	1,363	1,858	2,748	2,763	2,567	3,010	4,245
Non Wage	2,648	3,128	5,802	6,238	9,165	11,990	14,523
O&M	2,412	2,726	5,331	5,826	6,562	7,200	6,700
PAP	-	-	-	-	2,000	3,920	7,000
Subsidies	236	402	471	412	603	870	823
<i>Capital</i>	351	170	-	-	-	-	-
3-Youth and Sports	1,817	2,452	3,470	6,793	8,535	10,000	12,551
<i>Recurrent</i>	1,735	2,411	3,470	6,793	7,540	10,000	12,551
Ch 10 Wage	358	420	577	450	553	580	831
Non Wage	1,377	1,991	2,893	6,343	6,987	9,420	11,720
O&M	1,002	1,228	2,153	5,545	5,416	7,590	8,300
PAP	-	-	-	-	860	1,000	2,500
Subsidies	375	763	740	798	711	830	920
<i>Capital</i>	82	41	-	-	995	-	-
9-Provinces	70,755	84,716	117,148	127,330	161,816	166,990	190,981
<i>Recurrent</i>	70,655	84,716	117,148	127,330	161,816	166,990	190,981
Ch 10 Wage	61,424	75,919	106,656	115,613	127,739	145,000	173,091
Non Wage	9,231	8,797	10,492	11,717	34,077	21,990	17,890
O&M	8,180	7,762	9,148	6,074	18,391	18,000	13,900
PAP	-	-	-	2,572	13,065	-	-
Subsidies	1,051	1,035	1,344	3,071	2,621	3,990	3,990
<i>Capital</i>	100	-	-	-	-	-	-
Total Domestic	86,246	102,379	155,732	169,860	229,553	290,200	337,000
RECURRENT	83,403	102,025	149,781	165,815	212,205	286,200	333,000
Ch 10 Wage	64,766	80,046	111,972	121,028	132,088	160,792	192,707
Non Wage	18,637	21,979	37,809	44,787	80,117	125,408	140,293
Composition of Non-Wage		18%	72%	18%	79%	57%	12%
O & M for Administration	16,199	19,582	35,118	37,736	47,920	55,090	53,320
PAP		-	-	2,716	28,088	64,303	80,800
Subsidies	2,438	2,397	2,691	4,335	4,109	6,015	6,173
CAPITAL	169,343	180,354	158,676	162,384	131,984	94,700	89,700
Govt. Capital	2,843	354	5,951	4,045	17,348	4,000	4,000
Externally Financed	166,500	180,000	152,725	158,339	114,636	90,700	85,700
Total Govt. and External	252,746	282,379	308,457	328,199	344,189	380,900	422,700

Table A11: Government and Private Recurrent Expenditure by Level of Education

	1997	1999	2000	2001	2002
Total Government and Private					
Total	231,908	337,435	341,441	394,948	481,638
Primary	142,490	217,327	209,518	246,671	281,308
Lower Secondary	53,532	64,949	63,306	77,840	103,061
Upper Secondary	20,315	36,147	44,590	43,689	49,870
Post Secondary	7,967	13,551	15,032	18,532	31,514
Other	7,605	5,461	8,995	8,217	15,885
Private Share (%)					
Primary	65%	55%	50%	42%	37%
Lower Secondary	67%	56%	55%	54%	50%
Upper Secondary	80%	71%	70%	70%	67%
Post Secondary	50%	37%	40%	37%	24%
Other	0%	0%	0%	0%	0%
Total Private	37%	38%	37%	38%	39%
Recurrent	64%	56%	53%	49%	46%
Primary	65%	55%	53%	47%	45%
Lower Secondary	67%	56%	55%	54%	51%
Upper Secondary	80%	71%	70%	70%	67%
Post Secondary	50%	37%	40%	37%	25%
Govt. Recurrent Expenditure					
Total	83,403	149,781	165,815	212,205	286,200
Primary	50,006	96,839	105,722	143,119	178,625
Lower Secondary	17,680	28,558	28,757	35,852	51,183
Upper Secondary	4,101	10,373	13,340	13,286	16,507
Post Secondary	4,011	8,550	9,001	11,732	24,000
Other	7,605	5,461	8,995	8,217	15,885
Private Expenditure					
Total	148,505	187,654	175,626	182,743	195,438
Primary	92,484	120,488	103,796	103,552	102,683
Lower Secondary	35,851	36,391	34,549	41,988	51,878
Upper Secondary	16,214	25,774	31,250	30,403	33,364
Post Secondary	3,956	5,001	6,031	6,800	7,514

Source: Bank calculations using MEF TOFE for 1997-2001; Budget proposal for 2002; 1999 Poverty Assessment for distribution of enrolment by quintile for base year 1997.

Sources: Bank calculations using MEF TOFE for 1997-2001; Budget proposal for 2002; 1999 Poverty Assessment for distribution of enrolment by quintile for base year 1997.

Table A12. Comparison of ESP Program Cost Estimates and MTEF Budget Allocations, 2001-2005

Budget	2002		2003		2004		2005	
	(1)	(2)	(1)/(2)	MTEF ESP Cost	(1)	(2)	(1)/(2)	MTEF ESP Cost
Capital Expenditure	94,700	91,177	104%	0	84,980	0%	0	133,624
Total Recurrent Expenditures	286,200	327,726	87%	333,000	382,673	87%	399,180	490,027
Personnel costs (Ch 10)	150,040	210,630	71%	180,925	238,138	76%	220,780	282,087
Non-PAP non personnel budget	61,105	42,041	145%	58,875	51,335	115%	65,000	74,040
Ch 11 Operating costs	55,090			52,945				
Ch 31 & 32 Transfer payments	6,015			5,930				
Ch 32 Transfers to int'l organizations								
Priority Action Program (Ch 13)	75,055	75,055	100%	93,200	93,200	100%	113,400	133,900
1. Education service efficiency	11,200	11,200	100%	13,200	13,200	100%	14,500	15,500
2. Primary education quality & efficiency	24,000	24,000	100%	26,000	26,000	100%	30,000	35,400
3. Secondary educ. quality & efficiency	7,500	7,500	100%	10,000	10,000	100%	14,000	20,000
4. TVET quality & efficiency	1,820	1,820	100%	4,000	4,000	100%	5,000	6,000
5. Higher education quality % efficiency	2,100	2,100	100%	3,000	3,000	100%	4,000	5,000
6. Continuous teacher education	9,000	9,000	100%	9,000	9,000	100%	10,000	11,000
7. Core instruction materials	14,000	14,000	100%	15,000	15,000	100%	18,400	21,000
8. Non-formal education expansion	2,000	2,000	100%	4,000	4,000	100%	6,000	6,000
9. In school youth AIDS awareness	600	600	100%	1,350	1,350	100%	1,500	1,500
10. Out of school youth AIDS awareness	400	400	100%	1,150	1,150	100%	1,500	2,000
11. Strengthened monitoring system	2,435	2,435	100%	3,500	3,500	100%	3,500	3,500
12. Equitable access/scholarship	0	0	-	3,000	3,000	100%	5,000	7,000

Source: MOEYS & MTEF.

Table A13. Health and Socio-Economic Indicators for Selected Countries

	India	Bangladesh	Cambodia	China	Laos	Vietnam
Population (million)	1,008.0	137.4	11.7	1,282.0	5.3	78.7
GDP per capita		370	344	780	280	370
GDP per capita (PPP, 1999)	2,248	1,483	1,361	3,617	1,471	1,860
Gini index	37.8	33.6	40.4 (1999 CSES, 34.6)	40.3	37.0	36.1
HDI, 1999	0.571	0.47	0.541	0.718	0.476	0.682
HDI Rank	115	132	121	87	131	101
GDP rank less HDI rank	0	-4	13	7	-2	19
Infant mortality rate (per 1000 live births)	98	89	95	33	93	31
Maternal Mortality rate (per 100,000 live births)	410	440	437	55	650	160
People living with HIV (% adults, 15-49)	0.70%	0.02%	2.80%	0.07%	0.05%	0.24%
Malaria cases per 100,000 population	275	56	1,114	2	1,076	86
TB cases per 100,000 population	115	58	154	36	42	113
Total spending on health (% GDP)	5.1%	3.8%	3.1%	4.5%	4.1%	5.2%
Total public spending on health (% GDP)	0.9%	1.4%	\$20 to \$30	1.7%	1.5%	1.2%
Total health expenditures per capita (US\$)	22	12	344	34	11	19

Source: UNDP Human Development Report, 2001 and WHO World Health Report, 2002.

Note: Public spending, as defined in the WHO WHR, 2002, equals government domestic revenue funding plus external support from donors.

Table A14. Cross Country Comparisons of Coverage, Most Recent Year

Country	Primary			Secondary	Post Secondary
	Gross Enrolment Ratio ^{a/}	Net Enrolment Ratio ^{b/}	Completion Rate	Gross Enrolment Ratio	Gross Enrolment Ratio
Cambodia	124	86	60	24	1.4
Lao PDR	111	72	64	29	2.8
Mongolia	88		82	56	36.0
Vietnam	110	94	99	61	6.9
China	120	100	100	69	5.7
Indonesia	114	97	91		11.3
Malaysia	91	91	90	58	11.7
Philippines	117	100	92	79	35.2
Thailand	88		84	57	22.1
Hong Kong	96	91			28.0
Japan	102	100	100	92	42.7
Korea, Rep	94	92		102	60.3

Sources: World Bank Edstats. UNESCO 1999 Yearbook. MRY data are between 1997-1999.

Cambodia is 2001/02. Mongolia – Public Expenditure and Financial Management Review, World Bank, 1999.

^{a/} The gross enrolment ratio is the total enrolment divided by the population of official school age (e.g. 6-11 in primary, 12-17 in secondary)

^{b/} The net enrolment ratio is the enrolment of youths in the official school-aged range divided by the official school-aged population.

Table A15. . Major Revenue Sources of Provincial Governments as a Percentage of Total Revenues (using the budget of the provincial governor) for FY 2002

Provinces	Revenues from Duties and Taxes										Non Tax Revenues	
	Ch 10: Income Taxes					Ch 11: Wealth Taxes					Ch 20: Property Income	
	Tax on Used Land	Patente	Animal slaughter	Tax on Motor Vehicles	Excessive for Pub. Lighting	Total	Pre-paid changes for occupying pub. Prop.	Others	Total			
Banteay Mean Chey	0.1	2.3	0.5	25.2	0.3	33.0	3.9	0.8	33.0			4.7
Battambang	0.2	4.7	1.6	20.9	0.5	31.0	19.5	0.3	31.0			19.9
Kampong Cham	0.6	5.7	2.6	31.6	0.4	42.7	30.3	1.4	42.7			31.8
Kampong Chhnang	0.5	1.6	0.8	13.3	0.3	17.3	7.5	0.1	17.3			7.6
Kampong Speu	3.5	2.0	0.8	15.1	0.3	23.6	8.8	2.1	23.6			10.9
Kampong Thom	0.0	1.7	22	11.1	0.1	15.9	3.6	0.0	15.9			3.6
Kampot	1.5	3.1	21	9.2	0.3	17.7	7.3	2.9	17.7			10.3
Kandal	21.1	4.2	0.9	29.5	0.3	63.2	18.5	0.4	63.2			18.9
Koh Kong	0.9	1.8	0.7	5.3	0.2	9.4	22.2	3.3	22.2			25.4
Kracheh	0.6	2.5	1.1	6.9	0.1	12.6	15.7	0.6	15.7			16.3
Mondol Kiri	0.0	0.2	0.1	3.5	0.0	3.8	6.9	0.0	6.9			6.9
Phnom Penh	2.5	14.3	1.2	24.6	36.9	93.9	1.2	0.2	93.9			1.4
Preah Vihear	0.0	0.1	0.2	1.7	0.1	2.1	2.9	0.6	2.9			3.5
Prey Veng	0.1	2.1	1.0	10.5	0.2	14.4	5.9	1.3	14.4			7.2
Pursat	0.2	1.4	0.7	10.1	0.1	12.8	11.2	1.6	12.8			12.8
Ratanakiri	0.0	0.9	1.0	2.9	0.0	4.9	7.0	0.1	4.9			7.1
Siem Riep	6.8	12.7	24	17.1	3.8	56.5	4.6	0.7	56.5			5.3
Krong Preah Sihanouk	14.5	5.5	1.0	16.1	0.5	53.7	16.7	0.0	53.7			16.7
Stueng Treng	0.1	0.6	0.5	4.2	0.5	5.9	5.6	0.3	5.9			5.9
Svay Rieng	0.0	2.8	3.0	9.8	0.5	18.7	8.4	1.2	18.7			9.6
Takeo	0.2	3.1	1.9	12.0	0.0	17.8	12.8	0.0	17.8			12.8
Oldar Mean Chey	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			0.0
Krong Kep	0.8	0.4	0.1	0.9	0.1	2.9	0.7	0.0	2.9			0.7
Krong Palin	0.4	0.7	0.4	2.6	0.4	4.9	1.4	0.0	4.9			1.4
Totals	3.3	7.0	1.2	17.4	12.3	48.0	7.9	0.6	48.0			8.5

Source: Budget Law, 2002.

Table A16: Major Expenditures of Provincial Governments as a Percentage of Total Expenditures (using the budget of the provincial Governor) for FY 2002
(%)

Provinces	Menus and Services					Public Interventions		
	Ch. 10: Salaries & Allowances		Ch 11: Operating Costs			Ch 12:		
	S&A of Permanence Frameworks	Others	Equipment Spending for Adm. Mgr.	Others	Subsidies to Prov. & Municipalities	Total	Ch 31: Social Transfers	Total Expenditures
Banteay Mean Chey	7.2	0.6	74.7	3.8	13.1	99.4	0.6	100.0
Battambang	8.5	0.9	72.4	2.6	13.5	98.0	2.0	100.0
Kampong Cham	10.3	0.5	62.4	2.6	22.7	98.4	1.6	100.0
Kampong Chhnang	10.1	0.9	70.3	3.3	14.8	99.3	0.7	100.0
Kampong Speu	9.4	0.7	61.7	1.7	25.6	99.0	1.0	100.0
Kampong Thom	10.8	1.3	67.1	2.9	16.6	98.6	1.4	100.0
Kampot	13.3	0.2	65.2	4.8	15.7	99.3	0.7	100.0
Kandal	5.9	0.1	80.7	0.6	11.8	99.1	0.9	100.0
Koh Kong	5.6	1.4	78.5	6.3	5.8	97.7	2.3	100.0
Kracheh	6.8	1.3	78.9	3.4	8.6	99.0	1.0	100.0
Mondul Kiri	5.4	0.2	79.9	9.2	4.0	98.8	1.2	100.0
Phnom Penh	2.4	2.0	91.3	0.6	2.1	98.4	1.6	100.0
Preah Vihear	7.0	1.5	74.0	7.6	8.9	99.1	0.9	100.0
Prey Veng	13.0	0.7	62.5	4.9	17.8	98.9	1.1	100.0
Pursat	7.9	1.0	73.9	5.6	10.6	99.0	1.0	100.0
Ratanakiri	7.1	1.3	74.5	6.9	9.0	98.8	1.2	100.0
Siem Riep	8.2	0.7	69.7	6.4	14.4	99.3	0.7	100.0
Krong Preah Sihanouk	5.2	0.6	89.3	2.1	2.1	99.4	0.6	100.0
Stueng Treng	5.4	0.3	79.0	7.9	6.3	98.9	1.1	100.0
Svay Rieng	9.4	0.5	71.4	2.4	15.5	99.2	0.8	100.0
Takeo	15.0	0.9	55.9	2.0	23.3	97.1	2.9	100.0
Otdar Mean Chey	7.8	0.8	74.9	7.8	7.9	99.1	0.9	100.0
Krong Kep	4.0	2.0	85.5	6.7	1.0	99.2	0.8	100.0
Krong Pailin	7.1	1.6	77.5	9.1	2.6	97.9	2.1	100.0
Totals	6.4	1.2	78.8	3.1	9.2	98.7	1.3	100.0

Source: Budget Law, 2002.

Table A17. Budget Variance and Backloading 2000 and 2001

Economic/Sector Structure	2000		2001		2002	
	Central	Provin- cial	Central	Provin- cial	Central	Provin- cial
Recurrent –Defense & Security	99.1		99.1		94.4	
Recurrent – Civil Administration	86.7	93.2	100.1	97.8	75.9	94.7
Ch. 10: Salaries	104.9	94.8	99.5	92.6	120.5	103.6
Ch. 11. Operating Costs	99.7	82.1	112.5	92.7	76.2	80.2
Ch. 13: Specific Program						
Activities	95.4		76.3	98.5	67.4	96.0
Ch. 30: Economic Interventions	66.3	95.8	81.8	91.6	116.7	88.6
Ch. 31: Social Interventions	88.5	91.9	83.1	97.2	125.4	90.3
Capital	94.8		87.1		82.6	
<i>Total Treasury- Executed Expenditure</i>	92.4		96.1		84.6	
Education	64.2	98.5	61.3	105.3	43.5	91.6
Health	86.8	78.8	93.9	86.5	47.0	97.9
Agriculture	91.4	88.2	84.8	87.6	81.7	87.1
Rural Development	95.1	91.6	94.8	86.2	77.8	81.2

Source: Bank estimates based on MEF TOFE.

Table B1. Cambodia 1999 Public Expenditure Review
Summary of Achievement

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
I. Increasing Domestic Revenue Mobilization The current revenue effort is extremely detrimental to achieving sustainable development effort. The effectiveness of public expenditure policy as an instrument for accelerating growth and reducing poverty is severely constrained by weak revenue effort. The authorities must address weak governance with is the core of the current low revenue performance.			
1. The new measures of the Law on Taxation are partially implemented.	Fully implement the measures of the Law on Taxation.	Immediate	- The real regime tax system was expanded in 2000 to five provinces: Sihanoukville, Koh Kong, Siem Reap, Kompong Cham and Battambang. In 2002, the real regime system has been expanded to another five provinces: Kandal, Svay Rieng, Kampot, Kompong Speu and Kompong Chhnang. - The Prakas Tax on Profits was adopted on 3 August 2000. In the process of Implementation: The Government has embarked on a review of the tax system within the framework of TCAP: establishing an unambiguous depreciation schedule for tax on profit; revising the method of taxing dividends; reviewing anti-avoidance rules; preparing double taxation agreements; widening the tax base; reviewing the exemption level of the tax on salary; establishing and implementing a reporting system to follow up, at HQ level, on the evolution of tax arrears; establishing a modern management information system within the Audit division; and increasing the number of auditors and organizing appropriate audit training programs for auditors.
2. The implementation of the VAT has been delayed.	Effectively implement the VAT initially for 800 largest taxpayers beginning January 1, 1999: ➤ Swiftly issue the sub-decree on the VAT and supporting MEF regulations ➤ Continue and intensify the training at the Tax Department, education of taxpayers and publicity campaign.	Immediate Immediate Immediate	In the process of Implementation: Reviewing the VAT thresholds, with the possibility of lowering it slightly below the current threshold for goods; adopting selective methods to detect fraudulent invoices; streamlining the system for controlling refunds and developing risk assessment techniques for the verification and approval of VAT refund claims

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
3. The Law on Investment and the Implementing Regulations are too generous, posing one of the most critical impediments to improved revenue mobilization.	- Remove all the incentives currently granted to resource and resource processing firms from the Implementing Regulations. - Remove the production of consumption goods from the preferred sectors in the Implementing Regulations (but not retroactive). - Repeal the 9 percent tax rate, the tax holiday period, and the profits reinvestment rule in the Law on Investment, with grandfathering up to three years.	Immediate Immediate Medium-term	- After extensive consultations with stakeholders, in particular with the private sector, the amended Law on Investment was approved by the Council of Ministers and submitted to the National Assembly in March 2002. The amended Law on Investment includes the following elements: (a) The 9 percent rate was repealed and replaced with the profit tax rate in the Law on Taxation. (b) <i>The corporate tax holiday was not removed but modified.</i>¹ (c) The new law eliminates corporate tax exemptions for reinvested profits. (d) The new law removes tax exemptions on the distribution of dividends or profits or proceeds of investment. <i>The Law on Investment amendments did not address the issue of subjecting all imports to a duty at a reduced rate, taking into account the current outflow of investment from Southeast Asia to China.</i>
4. Despite its significant revenue potential, forestry continues to make a very limited contribution, as the severity of illegal logging has worsened.	- Immediately take "emergency measures" to arrest the deteriorating situation: stop granting new concessions; freeze approving all new investments in wood processing; establish mechanisms to monitor and prevent illegal log fellings and exports; enforce cancellation of all permits for collection" of logs and stop issuing new permits; and strengthen the Forestry Department. - Implement the recommendations of the four studies assisted by the Bank TA (i.e., legal review, forest concessions management, forest policy, and log control and monitoring) with a view to establishing an environmentally sustainable, economically sound,	Immediate Medium-term	Current Status: <i>Revenue potential of forestry has been reduced by illegal logging and the decline of international prices for timber products. Government efforts to reform the sector also involve a hiatus in revenues as new systems are installed.</i> The Government has undertaken the following measures: - The Government has stopped granting new concessions and has cancelled several existing concessions; - Some investments in wood processing have been frozen; - Mechanisms have been established to monitor and

¹ The exemption is stated as such in the new law: "A qualified investment project shall be entitled to exemption from the tax on profit imposed under the Law on Taxation for a tax exemption period. The tax exemption period is composed of a Trigger Period + 3 years + n years (n shall be determined in the Financial Management Law). The maximum allowable Trigger Period is to be first year of profit or three years after the QIP earns its first revenue, whichever is sooner."

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
	market-oriented forestry management over the medium term: ○ For next three months: prepare a proposal for illegal logging control; prepare the illegal logging monitoring program, undertake a performance review of concessions, and prepare the Cambodia Code of Forest Practice (CCPF). ○ In the subsequent few months: decide on the termination or renegotiation of concession contracts; prepare a sub-decree establishing the CCPF; strengthen the implementation capacity forestry management; and strengthen law enforcement capacity on illegal logging.	Immediate	prevent illegal log fellings and exports, though maintenance is a problem; • The Government has enforced cancellation of all permits for log collection and has stopped issuing new permits • The Forestry Department, including the Forest Crime Monitoring Unit, has undergone some strengthening. • The proposal for illegal logging control has not yet been completed, though the illegal logging monitoring program has been prepared. • The Government has undertaken a performance review of concessions. • The Cambodia Code of Forest Practice (CCPF) has been prepared and established by sub-decree. • The Government has not completed its review of concession contracts in terms of either renegotiating or terminating Not Yet Implemented: The Government has reviewed alternative mechanisms for timber royalties and is committed to maintaining the timber royalty at US\$54 per cubic meter. • The draft sub-decree on community forestry was finalized with the launch of consultation with all stakeholders. It is being reviewed by the Ministry of Agriculture, Forestry and Fisheries pending submission to the Council of Ministers.
5. Tax administration and governance in tax collection are weak.	• Ensure that all issues relating to taxation are included in the Law on Taxation with the Ministry of Economy and Finance (MEF) responsible for legislative drafts, implementation, and administration. • Eliminate the exemption from pre-shipment inspections for import for the projects approved under the Law on Investment, garments, and cigarettes.	Immediate Short-term	• Seven sectoral Working Groups were established within the framework of Government-Private Sector Forum and a comprehensive tax reform work plan is being implemented under TCAP. • The new PSI contract with SGS does not fully meet the recommendation, as the exemptions in the new contract are essentially unchanged with the following exceptions: (a) the PSI threshold for inspection was decreased from US\$ 5,000 to

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
	- Fully transfer non-tax revenues collected by line ministries to the Treasury. - Amend the Law on Taxation to require that any other exemptions not specified in the Law on Taxation should be void. - Strengthen the audit capacity of tax administration.	Immediate Short-term Medium-term	\$4,000 fob; (b) cigarettes are now exempt; (c) used vehicles are subject to inspection; (d) goods supplied to government from other governments are exempt; (e) SGS plays a limited role with respect to importation of petroleum products; and (f) imports of production inputs by investment companies are exempt. - The system of information exchange between the Tax Department, Customs Department, State Property Department, and CDC is operational, yet it remains largely ineffective. The Government has strengthened this information system by improving coordination under TCAP, yet much more needs to be done. - Tax returns are being audited using a new management information system in the Audit division; the number of auditors is increasing due to internal reallocation of resources, and the ministry is organizing appropriate audit training programs for auditors; if necessary, technical assistance to prepare and develop these programs will be sought under TCAP. - In the process of implementing under TCAP a reporting system to monitor the evolution of tax arrears and collection enforcement activities of tax offices. Also compiling information including ageing of account by tax, interest and penalties collected, number of accounts, dollars outstanding, budget to actual, and opening to closing inventory. - The Government is simplifying import clearance procedures at ports by enabling the Customs Department to manage the overall clearance process and specifying the procedures through which other government agencies will be involved in that process. However, problems remain: Customs and CAMCONTROL could make

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
			processes more efficient by reducing duplication of inspections. The Customs and Excise Department (CED) is in charge of the clearance process (the Economic Police are no longer involved). The Ministry of Commerce's CAMCONTROL is checking the quality of goods and the Certificate of Origin to prevent fraud, thus the revocation of MFN/GSP statuses. TCAP envisages the development and implementation of streamlined customs clearance procedures to enhance trade facilitation and improve effectiveness of operations and implementation of an enforcement strategy and programs based on the principles of risk management in order to reduce smuggling and other illegal cross border activities.
II. Improving the Efficiency and Equity of Public Expenditures through Expenditure Rationalization Despite its critical role in the development strategy through reconstructing physical infrastructure, developing human resources, and improving the accessibility of public services to the poor, the effectiveness of public expenditures is constrained not only by weak revenue efforts but also by low efficiency and equity associated with the allocation of public expenditures.			
1. Defense expenditure crowds out resources for spending on development activities	- Decisively implement military demobilization as envisaged under the Cambodia Veterans Assistance Program (CVAP). - Update CVAP. - For the following few months: identify and register special target groups; and implement pilot demobilization of special target groups.	Medium-term Immediate Short-term	Further information required. - The Cambodia Veterans Assistance Program (CVAP) was updated and the first round is being monitored so that the design for the second round can be improved. - Special target groups were identified and registered and the pilot demobilization project was completely implemented, discharging 1,500 soldiers (though the audit is overdue). 15,000 soldiers were demobilized (another 15,000 is planned for February 2003).
2. Despite the urgent need for human resource development which is critical to poverty reduction and economic growth, outlays on social	Substantially increase outlays for social sectors financed from revenue enhancement and also savings from military demobilization	Medium-term	Over the two years to 2002 the budget plan for recurrent spending on health increased by 42% and education by 56%. Moreover, actual expenditures (as a percentage of the budget allocation) for health have increased from 84.3% in 2000 to 91.8% in 2001, and for education from 92.6% to 95.0%, but

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
sectors from government's own resources are very low.			- back loading remains a serious problem. From 1999 to 2002 the budget allocation for recurrent spending on security and defense decreased by 18%. - Security and defense spending decreased from 42% of actual recurrent spending in 1999 to 29% in 2002 (Government-executed defense and security expenditures were reduced from a peak of 4.8 percent of GDP in 1997 to 3.2 percent in 2001).
3. The efficiency and equity of public expenditure within the social sectors needs to be enhanced	- Increasingly target services of government health facilities toward poorer individuals and underserved provinces and also from tertiary to primary facilities since the private sector caters disproportionately to the more affluent. - Implement pilot programs for cost recovery in the hospitals, including user charges, community-based prepaid insurance schemes, and contracting out of specific services in public facilities to the private sector. - Focus spending more on the provision of basic education and lower secondary education, with putting policies which encourage private sector involvement in upper secondary and tertiary education. - Regularize the current informal cost recovery program especially in higher education, with transparent user fee collection process and the collected revenues kept at the facility level.	Medium-term Medium-term Medium-term Medium-term	<i>No progress known.</i> - Cost recovery condition met in regard to user charges. Contracting in and contracting out pilots undertaken in MOH; analysis of experiences done and implications for reform under consideration. Progress in regard to community based insurance schemes and contracting out not known. - Public spending on primary and lower secondary education represents an estimated 82% of total public expenditure in the sector. MOEYS has prepared study on 'Private/Public Partnerships in Education Sector' (April 2001). In higher education a draft decree setting out the guidelines for accreditation of private institutions has been prepared. - New guidelines for private/public partnerships in financing education, especially vocational and higher education are planned in the Education Strategic Plan 2001-05, but to date no formal instructions have been issued. Fee collection practices continue (formally and informally) with little accounting for revenues and expenditures.

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
4. Owing to substantial over-employment, the wage bill is high despite the low salary level. The combined result of over-employment and low salary level leads to low operational efficiency of public service delivery.	- Decisively implement civil service reform - Strictly limit new hiring and reduce the number of civil servants through eliminating ghost workers and also through normal attrition. - Carry out a civil service census to provide a record of numbers and grades, education attainments, experience, and skills which will facilitate personnel planning. - Prepare options for the appropriate role of government, the appropriate structures for that role, the needed skills mix for the reformed government, and the pay, training, and recruitment policies to support that mix.	Medium-term Immediate Short-term Short-term	<i>Civil service reform has been slow.</i> - Under its National Public Administrative Reform (NPAR) program, the Government has recently taken a number of measures to improve the management and functioning of its civil service, including a civil service census and the reported removal of about 9,000 ghost workers (about 5%) based on census results. There do not appear to be limits on new hiring, as the total number of civil servants has crept upward (though data from MEF and CAR are inconsistent). - Government introduced a new classification and remuneration regime, which resulted in an increase in the average base salary in FY2002 and a modest decompression with the creation of a super category "AA" allowance for top officials. The Government also intends to create Priority Mission Groups (PMGs) – comprising targeted salary bonuses – for staff carrying out priority missions in central and line agencies in 2003. - Options for pay and employment reform are currently being investigated and results will be available by September 2003. The analytical work to be undertaken over the next several months will serve as the basis for a comprehensive civil service reform program.
5. The squeeze in civilian non-wage O&M and counterpart fund for externally financed investment results in the under use, or inefficient use of capital investment, and in ineffective service delivery.	Substantially increase outlays for civilian non-wage O&M and counterpart fund from revenue enhancement and also savings from military demobilization	Medium-term	<i>Largely observed.</i> Increases in Chapter 11 and PAP have substantially increased O&M expenditures in education and health. In education, however, there are questions about the effectiveness of Chapter 11 spending and in health maintenance spending is still too low.

Issues	Recommendations	Time Frame*	Achievement
6. Public expenditures are concentrated in Phnom Penh, which is not desirable as poverty is heavily concentrated in rural areas.	Reorient expenditures to rural areas as envisaged in the SEDP.	Medium-term	Some progress noted. Actual provincial recurrent spending fell from 36% in 2000 to 33% in 2001 of total spending. However, the share of primary education expenditure captured by the poor increased.
III. Enhancing the Effectiveness of Public Expenditure Management While highly centralized institutions and processes make a remarkable contribution to macroeconomic control, they are very detrimental to allocative and technical efficiency. The fundamental problem is that the Cambodian budgetary process has sacrificed too much in terms of allocative and technical efficiency to maintain aggregate fiscal discipline. Thus, the challenge is to improve the current unnecessarily large trade-off between the aggregate fiscal discipline on the one hand and the allocative and technical efficiency on the other. The top priority is for the government to respect the budgetary rules and processes. In this regard, reducing political interference in the budgetary process is a prerequisite for other reforms.			
1. Ensuring political commitment to an authoritative budget process.	- Minimize ad hoc spending decisions taken outside the budget preparation context. - Ensure that new spending measures do not exceed the reserve budgeted for this purpose where they are proposed during the course of the budget year.	Immediate Immediate	Some progress noted. Aggregate expenditure control has been largely effective (in most sectors budget execution has been below authorized appropriations). However, it is reported that some decisions are repeatedly taken outside of the annual budget process. Although monthly spending plans have been provided to line ministries, they are not implemented for the most part. The government is developing an MTEF with some sector expenditure data for health and education. Largely observed. It appears that the contingency fund was mostly used for the commune elections and in response to the floods of 2000.
2. Establishing responsibility for performance at the level of spending units in parallel with the strengthening of technical, financial managerial capacities.	- Undertake an evaluation of the effectiveness of the Accelerated District Development (ADD) system of the Ministry of Health (MOH) and plan a trial of a similar program-based scheme for other agencies (with Ministry of Education, Youth, and Sports as a priority). - Establish a financial management improvement team at the MEF to help agencies introduce ministry-wide accounting systems for reporting, analyzing, and benchmarking resource use by each of their	Medium-term Medium term	- The ADD review has been conducted by MOH with assistance from WHO, and some changes have been made (e.g., disbursements are now made through the provincial treasury system). MOH has subsumed the ADD system under PAP. - The PAP was expanded to the Ministry of Agriculture, Forestry and Fisheries and the Ministry of Rural Development in 2002.

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
	- functional units. - Prepare a timetable for introducing activity-based budget bids by line agencies over a five-year period.	Medium-term	<i>Some limited progress</i> has been made under MOH's PAP (with assistance from AusAid). A simple integrated accounting and management IT system (low end, off the shelf software using double entry accounting and pre-determined financial management and control modules) on a pilot basis at the central and provincial levels in MOH. <i>Some progress for PAP expenditures in the priority ministries.</i>
3. Rationalizing the roles of the central and provincial administration.	- Give priority to separating the roles of the line ministries and provincial governors in the disbursement of budget funds. - In parallel, upgrade the financial management skills of the regional units of line ministries within each line ministry.	Medium-term Medium-term	<i>Some progress. Achieved for PAP, but no known progress for non-PAP spending.</i> <i>Limited progress.</i> Achieved for seven provincial health departments. MOEYS Finance Department has been strengthened to support PAP, but BMC-level training has been limited to a one day orientation.
4. Developing financial participation schemes (i.e. user charging)	- Acknowledge the existence of financial participation schemes as a significant budget tool and progressively document the incidence and terms of such arrangements. - Develop a set of guidelines on the circumstances in which user charging is appropriate, the appropriate basis for determining charges, and the handling of associated equity issues.	Medium-term Medium-term	<i>Some progress. Achieved for health sector.</i> <i>Some progress.</i> Achieved for health sector.
5. Improving the allocative and technical efficiency of donor funding	- Initiate a Sector-Wide Approach (SWAP) in the health sector as the MOH has a better capacity and coordination between the MOH and donors is relatively close. - Address a number of system-wide issues such as managerial decentralization, reforms in accounting and budgeting systems, and changes in staffing incentives--in the health sector for a SWAP to be adopted effectively.	Medium-term Medium-term	<i>Some progress.</i> A sector wide management (SWiM) approach has been initiated in the health sector (this entails joint sector planning by donors and Government). <i>Some limited progress in health</i> (viz., new accounting system in seven provincial health departments).

<i>Issues</i>	<i>Recommendations</i>	<i>Time Frame*</i>	<i>Achievement</i>
6. Strengthening the Public Investment Management System (PIMS)	- Strengthen the line ministry's capacity in monitoring the implementation of the PIP. - Extend the development of the PIMS beyond a broad framework for linking capital budgeting institutions, to become a vehicle for developing concrete strategies aimed at overcoming the current weak link in the operation of the capital budget cycle.	Medium-term Medium-term	No progress known. No progress known.
7. Donors need to play a significant role to effectively complement the government's efforts	- Provide well-coordinated technical assistance and training to strengthen the line ministry's capacity in a more systematic and programmed manner. - Move toward better aid coordination, such as through a SWAP.	Medium-term Medium-term	Some progress. This is occurring to some extent under TCAP, which provides a coordinated approach to financial management reform. The Bank's Economic and Public Sector Capacity Building Project will also assist. Some progress. TCAP has improved aid coordination, while a sector wide approach (SWAP) to planning and financing has been adopted by donors in the education sector, and a sector wide management approach in the health sector.

CAMBODIA
Country Financial Accountability
Assessment

East Asia and Pacific Region
Central Operational Services Unit
World Bank, Washington D.C.

PREFACE

The Country Financial Accountability Assessment (CFAA) is a diagnostic study of the financial management of a country. It provides an objective assessment of the strengths and weaknesses of financial management operation, identifies the key risks and capacity gaps, and assists the government in developing a strategy for reforms and an action plan to improve financial management capacity in the public and private sectors.

The findings and recommendations of the CFAA are in agreement with the diagnostic and recommend actions of other Bank work that has provided assistance to Government in the specific area of public finance, in particular the Country Assistance Strategy (CAS) and the HIPC. The substantial part of the findings and recommendations contained in the CFAA provide strong support to the Government efforts to improve the management of public finance and to the preparation of the Poverty Reduction Strategy Credit (PRSC).

This CFAA was carried out by a World Bank mission in July 2002 under the umbrella of the Integrated Fiduciary Assessment and Public Expenditure Review (IFAPER). An earlier note was discussed at the first IFAPER workshop, held in October 2002 in Phnom Penh, attended by representatives of the Ministry of Economy and Finance, the line ministries, the International Monetary Fund, and the Asian Development Bank.

This report was prepared on the basis of the findings of a World Bank mission to Cambodia from July 29 to August 8, 2002, carried out by Mr. Wijaya Wickrema, Senior Financial Management Specialist and Ms. Agnes Albert-Loth, Senior Finance Officer. Mr. David Shand and Mr. Pierre Messali provided comments as peer reviewers. Comments were also received from Ms Nancy Chen. The team is grateful for the cooperation and advice provided by concerned officials of the Ministry of Economy and Finances as well as those of other public institutions in Cambodia.

This CFAA complements and forms part of the IFAPER. It draws on the experience of previous studies such as the IMF Review entitled "Public Expenditure Management Framework," September 2001, and the results of various Asian Development Bank as Technical Assistance projects. It goes further in evaluating the effectiveness of accounting and auditing at the national and sub-national levels as well as the oversight functions. The accountability framework and the important aspects of financial accountability in the country are thus covered.

Abbreviations/Acronyms

ADB	Asian Development Bank
ADD	Accelerate District Development
BMD	Budget Management Department
CDC	Council for Development of Cambodia
CIDA	Canadian International Development Agency
CFAA	Country Financial Accountability Assessment
CMC	Cash Management Committee
COM	Council of Ministers
C/SF	Commune/ Sankat Fund
DBFA	Department of Budget and Financial Affairs
DFI	Department of Financial Inspection
EEPPMU	Economic and Financial Planning, Policy and Monitoring Unit
FBC	Finance and Banking Commission
FC	Financial Controller
FCU	Foreign Currency Unit
FTB	Foreign Trade Bank
IMF	International Monetary Funds
IFAPER	Integrated Fiduciary Assessment and Public Expenditure Review
MEF	Ministry of Economy and Finance
MOEYS	Ministry of Education, Youth and Sport
MOH	Ministry of Health
MOP	Ministry of Planning
NAA	National Audit Authority
NBC	National Bank of Cambodia
NT	National Treasury
OPM	Office of the Prime Minister
PAP	Priority Action Program
PDAF	Provincial Departments of Finance
PDOEYS	Provincial Departments of Education, Youth and Sport
PER	Public Expenditure Review
PIP	Public Investment Programs
PT	Provincial Treasury
RGC	Royal Government of Cambodia
TA	Technical Assistance
TOFE	Table of State Financial Operations
TSA	Treasury Single Account
UNTAC	United Nations Transitional Authority for Cambodia
WB	World Bank

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EXECUTIVE SUMMARY

Context

1. The main objective of the Country Financial Accountability Assessment (CFAA) is to analyze the quality and reliability of the public expenditure management mechanisms in Cambodia and to assess the level of fiduciary risk associated with public expenditure. The second objective of the CFAA is to formulate recommendations designed to improve financial management in the public sector. The analyses and recommendations contained in the CFAA are critical to the Government's efforts already under way to improve public finance management. The CFAA will also make vital contributions to the future CAS and the PRSP.

2. The conclusion of the CFAA is that the legislative and regulatory framework governing public finances in Cambodia is generally acceptable, with the exception of the control function, which requires a complete overhaul. However, the implementation of public expenditure is very weak, resulting in a lack of transparency and a high level of risk concerning the reliability of public expenditure management. In addition, the financial management systems and procedures cannot be relied upon to provide any assurance that the public funds are used for authorized purposes. The system is all in cash based and most receipts and almost all payments do not pass through bank accounts. Such a system provides many opportunities for corruption and misuse of public funds. The action program proposed in the CFAA would in the long run, and with the support of other donors, improve substantially the reliability of public finance in Cambodia. Specific measures (in particular those relative to public accounting and control mechanism) should be implemented immediately and be fully operational by the end of 2003 (see action plan) in order to reduce the adverse impact of weaknesses identified and improve the transparency and efficiency of public finance management.

3. The Government with the assistance of IMF, has already started implementation of the recommended reform measures. The mission commends the government's efforts but note that progress is very slow due to many constraints faced by the government, serious weaknesses still remain. The Government has embraced an extensive reform initiatives sponsored by its development partners. These include major reforms such as performance based budgeting, budget decentralization, medium term budget framework, standardization of accounting and others. The agenda is totally beyond government capacity and misses fundamental weaknesses particularly in the payment and reporting systems. However, there is an urgent need to prioritize government's efforts if the reforms are to be successfully completed. The findings and recommendations of the CFAA, in particular the 15 actions of the attached priority action plan, should facilitate the government's selection of specific targets for improvement. The Bank has taken note that implementation of several priority actions, particularly those relating to accounting, was already in progress. The Bank would like to encourage the government to actively continue with these reforms, in particular the creation of an integrated accounting and budgetary information system.

Legal framework

4. The Cambodian system of public finance management is governed by a series of laws and ministerial decrees. This law is based in part on the 1993 Constitution, and more specifically on the financial system law adopted by the National Assembly, promulgated by Kram No 01 NS of

December 28, 1993. The Cambodia's budgetary and accounting law which is largely derived from the French system, constitutes a coherent and solid framework for the Government's budgetary policy and public finance management.

Budget formulation

5. The public expenditure system in Cambodia is governed by two basic rules, namely: separation of the responsibilities of the authorizing officer (Ordonnateur) and of the accountant (Comptable Public), and the rule of certification of services rendered. The budgetary procedure which is heavily centralized is the sole responsibility of the Budget Directorate (Directeur du Budget) who plays a pivotal role. The spending ministries are not yet sufficiently associated with the budget execution.

Expenditure Control

6. There are at least four systems of budget execution in operation. The rules governing the recording of expenditures for budget management reporting are mix of cash and accrual accounting. Under IMF recommended reforms, a treasury single account (TSA) was established with the National Bank. However, this account is not used as intended. Use of cash withdrawal orders to effect payments exposes these accounts for significant risks of misuse of funds.

7. MEF also maintains several bank accounts which are dollars denominated. These accounts are not under National Treasury control. There are no transparent rules for operation of these dollar denominated bank accounts. It is not clear whether receipts and payments from these accounts are fully reflected in the budgetary accounts prepared by the National Treasury.

8. The practice of offsetting tax and customs dues against government obligations to suppliers continue despite IMF recommendation to discontinue. Review by the mission revealed that there are more than 100 accounts still in existence. Operation of these accounts is another possible source of misuse of funds.

Treasury operations and Cash management

9. The management of the government's treasury needs to be improved: (i) National Treasury has no control over revenue deposit which continue to come through the bank account of collecting agencies; (ii) different divisions of the National Treasury still operate independently with separate data base to manage their operations; (iii) foreign currency accounts are held in the National Bank and operated by a separate department of MEF without any review by the National Treasury; and (iv) monitoring of the government's cash accounts take place exclusively on a daily basis, with no short or medium term vision.

10. Public The public accounting system suffers from numerous weaknesses, some of which are serious to affect the reliability of all government accounts. The problem identified are generally linked to poor management and lack of accounting procedures. There is no clear accounting procedures manual. The accounting system has evolved over the years and a combination of Soviet, French and Anglo-Saxon systems. Financial statements are not produced. The accounting system produces only a monthly trial balance. Numerous reports produced outside the accounting system are used for managerial reporting.

Auditing

11. The control system in Cambodia appears to lack the necessary focus on efficiency and it needs substantial improvements to provide satisfactory safeguards against inefficient and unauthorized use of public funds. The control system is heavily accentuated on ex-ante controls, mostly at the level of

budget execution. Ex-post controls are uncoordinated, and include several units working independently. These include: (i) Inspection General des Finances (IGF) which operates mostly on demand, (ii) Auditor General does not have sufficient capacity and resources to operate effectively, (iii) National Assembly does not have the capacity and resources to support the control function it is expected to assume, (iv) MEF Financial Controller which operates mostly on demand, and (v) internal audit function within the sector ministries are very weak.

Management and information systems

12. The management and information systems at the budgetary and accounting level suffer from serious flaws. The government has been attempting to remedy this situation for some time, but its efforts still need to be improved. Although an integrated financial management system should be the ultimate goal, the technical competency of staff and current development of accounting rules and regulations do not warrant embarking on a complex system for a time being.

Capacity building

13. The human resource situation in the MEF and other sector ministries is a major concern for the Government in its efforts to successfully implement the present budget reform. The staff in MEF and other sector ministries is also insufficiently trained in the computerized budget and accounting systems, and staff in the sector ministries need training in basic budget management as well.

Conclusion

14. In spite of the multiplicity of controls and the centralized nature of the PEM system, weak financial management practices pose serious fiduciary risks. The fundamental problems result from a weak control environment, severe weaknesses in National Treasury (NT) operations, especially in the area of cash management, inadequacies in the public accounting system, and weak internal and external auditing capacity. These problems are so serious that the Government's budget and reporting systems cannot be relied upon to expend resources in an accountable manner. These systemic weaknesses thus raise concerns about fiduciary malfeasance and possible corruption.

15. The current budget reform undertaken by the government constitutes a major initiative to ensure the long-term efficiency, effectiveness and transparency of the management of public funds. The impact of the reform so far encouraging but much remains to be done before implementation of the reform is fully effective, especially the accounting systems and capacity issues.

16. The measure proposed under the CFAA reinforce actions already under way to implement the reform as well as additional recommendations for the improvement of current actions, which should be included in the Bank's dialogue with the government. The short-term actions mentioned below, which should be completed within the next two years, are improvements on the existing government action plan recommended by the IMF. The actions include: (i) improved budget management capacity at the MEF, sector ministries and local government; (ii) develop accounting standard and reporting systems; (iii) establish an integrated computerized treasury payment system for accurate recording of all public revenues and expenditures; (iv) rationalization and integration of internal and external control processes. A development action plan together with an indicative timeframe is set out in Appendix 1 to this report.

17. The above measures would help ensure an efficient implementation of the public finance reform over a two year period would include the following action: (i) sharper Bank focus in its dialogue with the Government of Cambodia through a single public sector finance action program which would take into account the different instruments CAS, PRSC, HIPC; (ii) maintenance of tighter coordination by the MEF over all the donors' programs concerning public finance; (iii) dissemination of the CFAA and other donors' recommendations in country through a series of

workshops that would include the borrower and donors to ensure buy-in by both borrower and donors alike; (iv) assessment of the need for additional financial support to the borrower to facilitate implementation of the budget reform.

18. Specific areas of concern requiring additional work in FY 2004 include the following: (i) status of local government accounting and budget management; (ii) capacity issues and training requirements at all levels of the MEF, sector ministries and local government; (iii) dissemination of government accounts to the public and raising public awareness to public finance issues; (iv) review of the dysfunctional system of audit in public finance.

CONTROL ENVIRONMENT

Legal Framework

19. Cambodia is a very poor country with GDP per capita US\$260 and population 10.3 million. After 25 years of war and internal conflict, the Paris Peace Accords were signed in October of 1991. The Accords established the Supreme National Council (SNC), representing the four major Cambodian political factions as the transitional vehicle of Cambodia's sovereignty. They also established the United Nations Transitional Authority for Cambodia (UNTAC) to maintain peace and develop a neutral political environment in which free and fair elections could be held. The elections took place in May 1993 and a national government was established in September 1993 within a framework of parliamentary democracy, under a new constitution, with a constitutional monarch as head of state. International assistance resumed.

20. The Cambodian system of public finance management law is based in part on the articles 57, 90 and 91 of the 1993 Constitution. The public finance reform was initiated in early 1993, based on the studies that had been undertaken since July 1992, and led to the adoption by the National Assembly of the law on Financial System (Budgetary), promulgated by Kram No 01 NS of December 28, 1993. A series of legal and administrative instruments have been developed and implemented for the reform of public finance. The law on the Financial System (Budgetary) was first applied with the 1994 National Budget. Data analysis for budget execution were initiated during the budget execution in 1994. By 1995 and subsequently, these reforms had to be expanded, given greater clarification, accompanied by the necessary implementation measures. The overall rule of law from the financial and economic standpoint had to be completed with new legal and regulatory provisions.

21. Cambodia's budgetary and accounting law which is largely derived from the French system, constitutes a coherent and solid framework for the Government's budgetary policy and public finance management. The law defines the roles and responsibilities of the National Assembly, the Minister of Economy and Finance (MEF) and other public officials in the administration of revenue collection and expenditure management. The public finance in Cambodia integrates the budgetary principles, rules and practices relating to: (i) *Separation of the responsibilities* of the authorizing officers (Ordonnateurs) and of the payment officers (accountants/cashiers); (ii) *Unity*: according to this rule, all budget appropriations must be gathered in a single budget document. It is prohibited to make any collection of revenue or any payment outside of the budget. But in fact, the budget law is made of many different types of budget accounts; (iii) *Universality*: all revenues and all expenditures must be shown completely in one document. All receipts must not be contracted with expenditures; (iv) *Non assignment of receipts*: receipts must not be assigned to some expenditures. But in fact, many processes allow this affectation such as "fonds de concours" and "budget annex" or "comptes speciaux du tresor"; (v) *Annuality*: appropriations are available during only one fiscal year. But in fact, unspent funds can be carried over under certain conditions and, above all, capital expenditures are voted in a multi-year perspective, authorization program (AP) and Credit de Paiement (CP); (vi) *Specialization*: appropriations must be specialized by nature, destination or service. But in fact, some chapters are non-specialized and more frequently chapters are globalized.

22. The National Budget becomes the Government's financial program and the basic instrument for realization of four key financial functions of the State, namely: (i) resource mobilization, (ii) resource allocation, (iii) distribution function, and (iv) macro-economic stabilization.

Internal Control Environment

23. A sound internal control environment requires the existence of laws, rules and regulations, a leadership that sets the ethical and professional standards, a well motivated staff who understands the internal control rules, open communications and reliable monitoring and performance measurement.

Notwithstanding the existence of acceptable laws, rules and regulations, the Cambodian internal control environment lacks many of the above requirements. A poorly paid and a poorly trained civil service is not motivated to achieve high standards of performance in discharge of their duties. There are no minimum qualification requirements for technical staff. In the field of accounting and financial management, there are no recognized professional qualifications. Average civil service salaries are about \$28 (2003) per month and are not sufficient to attract qualified and experienced staff.²

24. A highly centralized public expenditure management system does not provide incentives for line ministry staff. Line ministries often maintain off-budget revenues to finance urgent expenditures given uncertainty about timing of cash release. This practice, and others like it, invariably provide opportunities for illegal fees and financial leakages. Moreover, there is no reliable monitoring and performance measurement system. Budgets are monitored in aggregate by MEF for compliance with overall budget ceilings. Individual ministries, MEF financial controllers, and National Treasury officers maintain separate databases to serve their individual control requirements. No attempt is made to reconcile these reports or relate expenditure to performance of individual spending ministries.

25. Furthermore, in some cases the principles embodied in the law are simply not followed. For example, the principle of separation of authorizing officer and payment officer is not applicable for some parts of the budget (viz., PAP). Certain revenue collections are not remitted to the budget, resulting in off-budget revenues and expenditure (this problem has been cited in the forestry case). The requirement that all payments above Riels 2.5 million be paid by check or bank transfer is not followed at all. These practices have been adapted over time in order to allow the system to respond to present needs. However, they contribute to a weak control environment by allowing opportunities for misuse of public funds.

BUDGET FORMULATION

26. For the most part, Cambodia's budget system continues to follow a traditional approach: resources are allocated to institutions through budget ceilings, the institutions prepare bids which comprise a detailed breakdown of the inputs they require, these are then negotiated with the Ministry of Economy and Finance's (MEF) Department of Budget and Financial Affairs (DBFA). The approved budget presents a detailed breakdown of inputs by chapter, distinguishing allocations for salaries and allowances, operating costs, economic and social interventions, and capital. Input allocations are further broken down into sub-chapters, which are used for the purposes of budgetary control, and line items, with a total of forty-three line items detailed in agency budgets for operating costs. Agencies have limited authority to alter the composition of inputs during execution – virement within chapters has to be approved by the Minister of Economy and Finance, and between chapters by the Office of the Prime Minister (OPM). Weaknesses in the budget execution and cash management processes mean that the strategic prioritizations that are made in budget preparation are often not delivered.

Current System

27. ***Budget calendar and macro framework:*** There is a sound well-established budget calendar in Cambodia. It begins in May/June with the derivation of the macroeconomic aggregates of the budget. Revenue projections, which are mainly based on GDP growth projections, determine the resources available for the forthcoming year. The Royal Government of Cambodia does not, at present, borrow from the domestic banking sector to finance current budgetary expenditures, a provision that is enshrined in the annual budget law. In the macroeconomic planning of the budget, the MEF aims to operate a small current surplus to finance capital expenditure (largely counterpart funds for donor-financed projects). The capital budget is financed from concessional project support loans.

² Most civil servants admit that they have to do a second job to earn a living income.

28. **Departmental ceilings:** Once revenue availability has been determined, a process of prioritization allocates revenues between current and domestically financed capital budgets and between broad economic sectors. These ceilings are primarily incremental but adjustments are made at the margin to take account of high-priority policies (e.g. increases in the sector allocations are approved by the Council of Ministers).

29. **Budget circular:** The approval of the Council of Ministers signals the beginning of the construction of line department ceilings, which are transmitted to line ministries with a detailed budget circular in late July. The circular details the general policy stance of the budget and the ceiling for domestically financed expenditure for each ministry. The envelopes for each ministry are derived with reference to the current year's budget and expenditure performance to June when the first budget review is conducted with adjustments for the policy priorities included in the sectoral planning process. The ceilings contain an implicit planning reserve; they are set lower than total projected resources in anticipation of new expenditure requirements being introduced into the budget process.

30. **Spending agency submissions:** Ministries are required to provide detailed estimates for their expenditure by chapter, subchapter, and line item by the middle of August. These are prepared with reference to the needs of each ministry's various provincial and district offices (this is in contrast to budget execution when the provincial departments of the ministries fall under the control of the provincial administration). The level of sophistication varies by line ministry. The ministry of Health, which has had substantial technical assistance, has developed a simple formula based on fixed and variable costs to determine the funding needs for operational costs for each of its provincial departments and major health institutions. Other ministries have less sophisticated methods of delivering their budget bids.

31. **Negotiation process:** Following the receipt of ministry bids (which generally exceed the predicted ceilings), a process of discussion and negotiation takes place in September/October. These discussions are often highly detailed, with the Department of Budget questioning individual line item bids. Decision are often referred to the level of Finance Minister or Prime Minister. Upward and downward adjustments are made to take account of competing priorities. A draft budget finally emerges and is submitted for approval to the Council of Ministers and onward to the National Assembly for approval by the last week of December.

32. **Dual budgeting:** The capital budget is almost entirely foreign financed; only the small domestically financed component (mostly counterpart funds) is subject to normal budgetary discipline. During the 1990s, considerable effort was put into the establishment of a rolling, three-year Public Investment Program, managed by the Ministry of Planning (MOP). This sought to match top-down allocations for investment, based on a macro-economic framework for the budget agreed by the Council of Ministers, with programmed allocations for on-going projects and a prioritized listing of new investments presented by the line agencies. MOP is supposed to appraise line ministries' proposals to determine whether they meet government's development priorities and whether costing is realistic.

33. Unfortunately, the PIP has had little impact on the expenditure management process or expenditure outcomes. Project proposals are subject to cursory review. The result is a shopping list of projects. Allocations for capital expenditures, through the budget's Chapter 50, are supposed to reflect the domestic financing requirements identified in the PIP. In practice, no such allocations are made. Instead, the investment budget is managed by the MEF's investment department, with funds allocated to projects approved by the Council of Ministers or the OPM directly. A listing of investment projects is presented in the annual budget, though additional projects are approved in-year. Usually expenditures are posted against the nominally responsible agency, though this is not always the case. Allocations of counterpart funds are made in much the same way. As a result, the recurrent budget process is largely divorced from that of the capital budget.

34. The PIP has now lost credibility as a planning tool. Agencies recognize that the PIP plays no meaningful role in investment decision-making, submissions are tardy, with scant information on proposed projects and virtually none on actual disbursements, while preparation and Council of Ministers approval of the annual PIP tends to slip outside the budget calendar or—as in 2001—is dropped altogether. As proposed in the previous PER, with the introduction of the MTEF attention should turn to the integration of the programming instruments.

35. **Legislation:** The 1993 Organic Law and subsequent further decrees govern the annual budget law. The annual budget law grants the executive the right to collect revenues up to amount specified in the budget and sets expenditure ceilings for the two budgets. Details of functional ceilings and broad economic category of spending (split by central operations and provincial operations) and project investment are annexed to the budget. The National Assembly does not vote detailed line item allocations. The annual budget law specifies the rights and responsibilities of MEF and line ministries in budget execution. It also sets out borrowing limits, the manner of management of commercial enterprises, and the accountability for budget execution.

Analysis

36. It could be argued that the framework for budget preparation and management, though characterized by a high degree of central control, has many desirable features for a country that faces significant macroeconomic challenges, in particular from a narrow and fragile revenue base, a poorly developed financial system, and weak governance structure. Budgetary expenditures are constrained to available revenues and borrowings tightly controlled to make use of concessional expenditure and avoid inflationary financing.

37. However, weaknesses in budget preparation and execution mean that the budget often performs poorly on technical and allocative efficiency grounds. The budget preparation process does not facilitate appraisal of spending plans in relation to medium term policy priorities; in many instances, it is overly fragmented and lacks transparency; it does not provide enough information for cash management purposes to facilitate the implementation of expenditure programs; and the budget execution process can reprioritize budgetary decision on an ad hoc and nontransparent basis.

38. Incremental single year expenditure planning frustrates the efficient and effective realization of the government's policy priorities and impedes the ability of line ministries to plan service delivery. Owing to the concentration of human resources on expenditure control, there is a lack of capacity in the MEF to assess the efficiency or effectiveness of expenditure programs of line ministries. Most line ministries, with the notable exceptions of education and health, are not able to effectively manage resources and plan for the medium term, owing to the centralization and short term focus of budget decision making. The MEF is conscious of a wide range of expenditure pressures over the coming years, and has initiated work on a medium term expenditure framework (see IFAPER main report - chapter 4).

39. The functional separation of the current and capital budgets frustrates coherent implementation of the government's policy agenda. The separate budgeting and execution systems distort the budgetary prioritization process. The allocation of counterpart funds from domestic resources is effectively determined outside of the MEF, which further complicates cash management within the budget year.

40. In some instances, revenues that are budgeted as fungible state revenue are in fact earmarked for discretionary expenditure during the budget year. The budget that is formulated, therefore, is not a fully transparent statement of the spending intentions of the public sector. This practice contributes to the cash flow problems experienced by the main service delivery ministries in budget execution.

41. The budget classification structure does not allow meaningful analysis of the economic impact or policy focus of public spending. It reflects a narrow control focus, which only allows highly aggregated analysis of the economic impact of public sector activities. For expenditure reforms to be effectively pursued it need to be reformed to facilitate the planning control, and monitoring of expenditure in relation to its policy goal.

Recommendations

42. ***Improving expenditure planning and programming:*** In order to make this significant advance in budgeting in Cambodia a transition must be made from the single year, control focused expenditure planning currently conducted in the MEF to a more transparent forward looking process based on policy objectives. This is particularly important given the increasing number of expenditure pressures anticipated by the Ministry over the coming year, for example, from commune and national elections, increasing allocations to social sectors, ASEAN obligations, administrative reform, and military demobilization.

43. Given the limited technical and physical capacity in the Economic and Financial Planning, Policy and Monitoring Unit (EFPPMU) and the Department of Budget, in the short term this exercise will be largely limited to increasing the amount and quality of information submitted to the MEF during the budget preparation process. This will enable an analytical basis to be slowly built up that facilitates expenditure prioritization according to medium term policy objectives. The parallel reform in budget execution (moving from pre-audit to post-audit) should eventually free resources within the Department of Budget to undertake more expenditure programming and assessment functions. A key principle of the reforms is to increase the planning and programming capacity in the line departments so that the MEF can concentrate on overall budget policy rather than detailed control.

44. ***Decreasing fragmentation and improving transparency in the budget process:*** Ultimately, there should be a single consistent budget preparation exercise that clearly exposes and determines trade-offs between all public operations. All inflows, including donor-funded project expenditure should be included in the exercise. At present, there is serious fragmentation in budget preparation and execution that need to be resolved. The most serious problem is the disconnect between current and capital expenditure. In order to reassert the unity of the government budget, it is crucial to reform institutional relationships in the preparation on the investment budget and integrate it with mainstream expenditure planning.

45. The MoP and the CDC should remain responsible for the long term development plans, including contributing to the broad strategic development priorities. The MEF should have sole responsibility for decisions on the aggregate allocation and commitment in the annual budget which includes investment funds. Ultimately, one would expect that a fully unified system for preparation and execution of public expenditure would exist irrespective of the funding source. In the immediate term, however, integrating the execution system is not a reasonable expectation in Cambodia.

46. Another element of fragmentation is the practice of pre-assigning some revenues to particular accounts in the NBC, which are not accessible for normal budget execution. At the time of budget preparation, all these revenues taken into consideration as available for budget financing, and the aggregate budgetary expenditure is determined accordingly. Some of these accounts may be used for unbudgeted discretionary expenditures outside of the budget control system.

47. ***Improving budget classification and establishing a program budget framework:*** The current budget classification system is a mix between high level aggregates and overly detailed descriptions of activities. The budget is organized according to organizational structure, which broadly corresponds to functional classification. Within an organization, it is organized according to chapters, which provide economic classifications. It is, however, not organized in any kind of program format, which makes it difficult to determine the cost of a specific objective or program, and the final output. As such, it does

not allow meaningful economic or policy analysis of public sector operations. In addition, the expenditure planning and programming reforms envisaged above require line ministries to be able to plan and budget according to individual policy outputs (or programs) and for the MEF to be able to allocate, challenge, and monitor on the same basis. The ministry has expressed a desire to better understand the extent to which nonsocial sector ministries are actually implementing social programs. This requires moving toward a system of program oriented budgeting.

48. The priority in Cambodia is to reform the classification system to allow coherent financial reporting. The new system should allow classification of expenditure by function and economic category as described in the new Government Finance Statistics annual. A budget classification system usually consists of five dimensions to retrieve the information necessary for public expenditure management: (i) Source of Funds; (ii) Organization; (iii) Functional; (iv) Programs (activities and projects); and (v) Economic.

EXPENDITURE CONTROL

3.1. The process of budget execution has been revised and reformed in a number of ways during the last decade. Partly as a result, the current system combines a small number of recent, post United Nations Transitional Authority for Cambodia (UNTAC), modifications with elements of the French system and centrally managed (Soviet systems). In general, initial attempts in the first half of the 1990s to devolve responsibility for budget implementation have been rescinded in an effort to regain tighter central control of finances.

49. As in many developing and transition economies, the current and capital budgets in Cambodia are executed through largely separate institutional procedures. In 2001, financing for approximately 70 percent of capital expenditures is expected to come from donor sources (grants and loans). Most of this expenditure is made offshore (in the form of goods and services), hence only a small proportion of these funds is expected to be channeled through the Government budget implementation processes. The execution of current and capital expenditures, therefore, needs to be considered separately in each case. They each have particular strengths, as well as some very considerable weaknesses.

50. At present, the institutional responsibilities for current budget implementation in Cambodia are divided between the MEF (in conjunction with the line ministries) for expenditure authority and the National Treasury (NT) for payments systems. Although, the NT is technically a department of the MEF, it is physically, a separate institution, operates with relative autonomy from the rest of the ministry, and has its own distinct institutional features and problems.

Current situation

51. A key feature of the process is the ex-ante (pre-audit) control of spending. Approval by the National Assembly of the annual budget law relates only to the global appropriation amount, major aggregates (revenues/expenditures, capital/current spending commitments and disbursements, and provincial/municipal budgets), and the associated borrowing and amortization arrangements. Aggregated tables are attached to the Budget Law specifying estimates for revenues (by chapter, article, paragraph, and subparagraph), for recurrent expenditures (by spending agency and chapter), and for capital expenditures (by program/project).

52. The MEF is primarily responsible for overseeing the implementation of the current budget. Two departments: the Budget Department and the Treasury Department (NT) have the key roles. Line ministries and provincial administrations are also directly involved but have limited powers and accountability. There is widespread dissatisfaction with several features, and consequences, of the current procedures. Notification of spending agency appropriations and approval to begin

implementation of the Budget Law is issued by the MEF in January. However, this notification only permits spending agencies to begin to seek approval for individual expenditure commitments. There is no system or authority by which the MEF issues quarterly or monthly cash releases to spending agencies.

53. The budget implementation procedures are simple and clear according to the law. The *normal procedures* require four phases: (i) commitment; (ii) liquidation; (iii) authorization; and (iv) payment. The commitment phase requires submission of a proposal by the requesting ministry with a proforma invoice, verification of budget availability, signature of the requesting minister and pre-audit of the proposal by the financial controller of the MEF. This is the most time consuming part of the process and has allowed considerable power to MEF to exercise control over the spending authority of the ministries. The spending agencies must seek MEF approval throughout the year for individual purchase requests. The principal initial documentation for this process comprises the “commitment visa”, which is authorized at the appropriate delegated level in the MEF. The Financial Controller assigned to each spending agency, but located in the Budget Department (MEF) administers this pre-approval (pre-audit) process. Each commitment visa may require up to about ten signatures, depending on the required level of authority within the MEF. The time required to effect this process may extend from a few days to a few months. As of 2003, however, financial controllers are being out posted in MOEYS and MOH on a pilot basis.

54. The liquidation phase establishes the delivery of goods or services and the amount of the liability to the suppliers. Following above verifications, a payment order is prepared and passed on for authorization of payment. The MEF financial controller is then required to examine the payment order for completeness and authorize the payment. The authorized payment order is then passed on to the treasury to effect payment. The Provincial Treasury (PT) follow a similar procedure in the case of both provincial and central payments. Once this control procedure is complete, spending agencies may proceed to implement the required budgetary operation/activity, though there is still no guarantee that this can be completed without considerable further delays. A second key feature of the current process is that a very high proportion of current expenditures, including salaries, are executed in cash. Thus, irrespective of the signed commitment visa, payments may only be executed if there are sufficient cash resources available at the required location.

Analysis

55. The strengths of the current budget execution system are few, though not inconsequential. In particular, tight control of spending is maintained in an environment characterized by severe budget constraints, major shortfalls in financial management skills, and frequent lapses in public administration ethics. On the whole, positions and responsibilities involving the execution of budget expenditure are tightly defined and the basic systems and practices for accounting are widely observed. The above process has led to many problems in budget implementation. There are no standards of performance that requires various actors of the process to complete their respective tasks. It is also not clear what criteria is used for prioritization of commitment requests when budget constraints are faced. It is alleged that, given chronic cash shortages faced, the system allows extraction of fees to process authorizations both at commitment and payment stages.

56. As the *normal procedures* have led to delays in budget implementation, special procedures have been designed to overcome these difficulties. One such special procedure is the Priority Action Program (PAP) wherein funds are released on a quarterly basis to fund operational expenditures in the ministries of education and health. The PAP budget for fiscal 2002 for education was not spent as of July 2002 due lack of agreement between MEF and the Ministry of Education on objects of expenditure. Although the PAP budget for health was released, there has been very little oversight exercised by the MEF or the Treasury on actual spending. The accounting and reporting arrangements

are not very clear. The Budget Strategy and Enforcement Center, a special unit created within MEF to manage the PAP budget, has stopped functioning.

57. Another special procedure is advance of petty cash to pay operational expenses under the Accelerated District Development scheme (ADD). Essentially, these procedures shift expenditure management from pre-audit to post audit. Although they are both acceptable models to avoid excessive ex-ante controls and shift accountability to spending ministries, the experience so far indicate that they have not fully met their objectives.

58. A recent addition to this multiplicity of budget execution procedures is the Commune/Sangkat Fund (C/SF). The C/SF is created to finance operating and investment costs of the recently elected commune councils. These number about 1,600 units throughout the country. The C/SF has entirely different expenditure management procedures compared with regular or PAP procedures. The provincial treasuries act as cashiers but authorization of expenditure is solely with the commune chiefs. There is no requirement of "pre-audit" and it is not clear what other audit arrangements will be in place.

59. The evolution of different procedures of budget execution has resulted in weak institutional and organization environment as staff are constantly faced with confusing and contradicting processes. The current budget execution and reporting systems cannot be relied upon for accurate measure of accountability and poses serious fiduciary risks. The alternative procedures devised clearly contradicts the Organic Budget Law. There are inadequate internal control procedures to ensure that devolved funds are used for purposes intended. Reliable internal or external audit systems are not in place. The ability and skills of financial management staff at the ministerial level are not sufficient to manage such a shift in budget responsibility and accountability.

60. Even though aggregate targets have been met, there is considerable variance in budgetary performance against initial allocations at the agency level. Central agencies tend to overspend. For agencies' provincial administrations, the problem is rather one of under-spending. In 2000, twelve of the twenty agencies with provincial administrations reported shortfalls against provincial administrations' budget allocations, amounting to 40 percent of initial allocations. Provincial execution performance improved markedly in 2001 and 2002, but provinces' execution rates, the proportion of provincial administrations under-spending, and the overall level of under-spending were still worse than for central agencies. Implementation constraints are one factor contributing to the provinces' poorer execution performance, but this may also be a consequence of the lower priority accorded to provincial governments in allocating available cash. Execution rates have tended to be lowest for provincial operating expenditures, since salaries and social interventions are generally given higher priority when funds are scarce. In contrast, execution rates for PAP have been significantly higher both in comparison to funding for provincial agencies' operating costs and in relation to special program activities at the central level.

61. Additional factors contribute to the problem. Firstly, delays in the communication of budget allocations to agencies after the budget law is passed by the National Assembly hinder the preparation and clearance of mandates in the early months of the year. Secondly, agencies often batch expenditure mandates for submission to MEF. Once submitted, MEF may delay the mandates' approval pending verification of availability of funds. Third, like agencies in most countries, there is an end of year rush to submit mandates for any remaining budget balances, and corresponding rush on the part of the MEF to clear mandates so that they can be expensed. This in turn reflects the limited program implementation and budget execution capacity at the agency level. The rapid increase in agency budget allocations in recent years has aggravated these problems, as suggested by the steady increase end of back loaded expenditures seen in 1999, 2000 and 2001. A further contributing factor has been the introduction of PAP, which has required the release of substantial mandates directly to education, health and agriculture, thus aggravating the liquidity constraint.

62. Lastly, the environment for budget execution is heavily influenced by the legacy of central control. O&M expenditures are prescribed by MEF in fine detail (43 items) in Chapter 11 of the budget.³ Virement (to transfer funds within budget chapters) requires the approval of the Minister of Economy and Finance. Transfers between chapters require the approval of the OPM (and transfers between ministries require parliamentary approval). This inhibits cost effective and flexible program management.

63. A key feature of budget execution (other than for the Priority Action Program) is pre-audit of all but minor spending at national and provincial level by MEF financial controllers. Multiple signatures are required for anything but trivial spending approvals while procurement committees slow disbursement markedly. Expenditure approval processes in the provinces are equally complex. A single disbursement can require signatures from the spending line ministry, the PDAF, the provincial governor, and the Provincial Treasury (PT). The irony is that these centralized, bureaucratic control procedures do not seem to provide for fiduciary accountability, though they do undermine effective and efficient expenditure management.

64. The weaknesses of the current system, however, are substantial. These can be summarized as follows:

- Budget execution is often extremely slow, in particular through the pre-audit process.
- Multiple steps/ signatures appear to strengthen “control”, but diminish accountability.
- Many pre-audit procedures (signatures) for expenditure are perfunctory and add no value to the final decision.
- The process is labor intensive and encourages spending agencies to adopt strategies for managing/facilitating of flow of “their” papers through the MEF ahead of others.
- Budget expenditures are very uneven throughout the year and tend to surge in November and December in an attempt to implement delayed programs.
- Lack of cash frustrates implementation of the approved budget.
- A very long “complementary period” to February 28 annually is required to finalize (liquidate) expenditures committed during the final two months of the fiscal year.

Recommendations

65. The IMF Report discussed several budget management models and recommended that the budget executing responsibilities be realigned between MEF and the spending ministries by transferring the Financial Controller (FC), currently resident with MEF, to the spending ministry. The FC will report to the Secretary of State of the ministry but will also have a reporting responsibility to Head of Budget Management at MEF. The mission fully endorse this recommendation. The principal features of the recommended model are given below, though this model should be considered an ideal to be attained over the long term.

66. There will be a single budget execution procedure (replacing current normal, PAP, ADD and C/SF procedures). After the budget is approved, the MEF informs the line ministries/agencies about the approved annual appropriation. The line ministries and MEF agree on a monthly and a quarterly cash plan for cash management. MEF issues authorization to draw money from the Treasury and start the spending process. This could be by an issue of a warrant or notice of cash allocation for a specific period (month or quarter).

67. The spending ministries prepare expenditure commitment, liquidation and authorization following the *normal procedures* currently in place. The FC, after verifying that spending request is

³ MEF usually fixes ceilings at the sub-chapter level, with agencies allocating within these ceilings.

within the budget and cash allocation, authorizes commitment for spending and the final payment. The Treasury makes payment and adjusts the cash and budget balances of the spending ministry.

68. Under the above model, MEF will exercise control over budget spending by approving the original appropriation and by issuing cash allocations. Within these authorizations, considerable discretionary powers would be devolved to spending ministries to prioritize expenditures within available cash allocations. A system of issuing cash allocations would also provide certainty to spending ministries and improve budget execution.

TREASURY OPERATIONS AND CASH MANAGEMENT

69. The institutional design of the current treasury system in Cambodia has much to recommend a strong NT supported by a network of Provincial Treasury branches; comprehensive coverage of all public transactions at levels of the government; and consolidation of all custodial functions, including accounting, of public money in the NT. It also functions as the cash manager of the government and provides liquidity to all the line agencies and the provincial governments.

70. However, shortage of cash to finance the budget during the fiscal year has been a recurrent theme at nearly all levels in the government, from line agencies to the provincial authorities. The MEF has tried to address this issue in many different ways: cash rationing; establishing different systems for implementing the budget to ensure that priority expenditures are met; preparing annual and monthly cash plans; and regular across-the-board ad hoc cuts in cash allocation. All these initiatives have succeeded in improving cash management only partially (if at all). Such ad hoc solutions have created multiple systems for executing the budget. The main problem is that cash shortage is symptomatic of many system-wide basic flaws in expenditure management. Any improvement in cash management will depend upon the reform of the other critical systems: establishing a rule-based and transparent system for cash allocation; making payments; accounting system; and treasury reforms.

Current system

71. The actual functioning of the NT, however, has many features of a centralized command economy. Its main focus has become control of liquidity and cash in the system, and, as a result, its sole task seems to be to collect cash and provide liquidity to its clients the line agencies and the provinces. The NT, in addition to being the principal cashier for the government, carries out banking functions for some private sector suppliers to the government. One of the notable features of the current financial system in Cambodia is the near absence of viable commercial banks, except for FTB (a subsidiary of the NBC), and two or three other banks (mainly in Phnom Penh all of which do not undertake retail banking operations). The NT, for example, maintains deposit accounts on behalf of private sectors supplier of goods and services to the government. After the goods and services have been supplied in the fulfillment of a contract, and the NT receives payment order, it transfers the amount of payment to the deposit account of the supplier maintained in the NT. The supplier can use this account for payment of his dues to the government such as taxes and other revenues and payment of government obligations. These transactions are done by cash deposit and payment, or by carrying out off-setting accounting entries to reflect collection of revenues or payment of expenditures. However, the supply of cash to the supplier, for larger amounts of payment, requires another step in the process specific authorization from the MEF.

72. The National Treasury (NT) and its network of provincial treasuries are the main custodian of the government's financial assets and the centers of public accounting. Organizationally, the NT is part of MEF. *However, in practice it operates very independently.* The foundation of NT operations is the budget law, which requires that all public monies collected be deposited with the NT and all payments on behalf of government be made by the NT. Thus, all payment orders, after having been approved by the requesting ministry and pre-audited by MEF, are forwarded to the NT, which reviews

the documentation for completeness. Payments are effected in two ways: by cash or by crediting the account of suppliers that maintain deposit accounts with the NT. The paid payment orders are then passed on to the NT's accounts division for accounting purposes. The NT maintains the Government's books of accounts and is the only place where accounting records are kept based on double entry accounting principles. There are no accounting records maintained either by the spending ministries or financial control department of MEF.⁴

73. The main power of the NT comes from its power to provide or to deny cash to an agency. All the treasury transactions collection and payment of money are in cash. Providing liquidity to the line agencies and the provincial treasury involves moving a considerable amount of cash daily from one location to another. Each day the NT transports currency to different regions. Central ministries collect cash from the treasury office in Phnom Penh. The provincial treasury remit surplus cash (after meeting their requirements) by currency transfer to the NT. Owing, however, to the lack of adequate communication facilities in the information system, and (most important) uncertainty surrounding cash allocation, the NT often does not have a full picture of cash available in the provincial treasury or with the line agencies.

74. The cash management system as currently designed has certain strengths. In theory, cash allocation should be made according to a cash plan that the MEF prepares at the beginning of the fiscal year. The MEF prepares annual as well as monthly cash plans covering both the central and provincial levels. However, in practice this system does not work. Many factors affect proper management of liquidity: the daily movement of cash from one location to another; the lack of modern communication facilities; the absence of a banking system; and uneven cash inflows leading to seasonal cash shortages. These factors have, in turn, introduced distortions: retention of cash by the line agencies; lack of information by the NT on the exact amount and timing of inflows; netting of liabilities by the private sector and autonomous agencies before remitting any money to the NT; and a general lack of transparency in all financial transactions.

75. The Government's cash resources are not managed from a single fund as provided for under the law, but are fragmented so that Treasury only has access to a small part of Government's total deposits. At end June 2002 about 10 percent of the RGC's financial assets were available to Treasury for the purposes of budget execution (liquid assets then amounted to about 6.6 percent of the total Treasury executed budget, riel liquid assets just 2.8 percent). By the end of December, liquid assets had dropped to 5 percent of total assets.

76. The management of cash resources of the government is fragmented. The government has some accounts in the National Bank of Cambodia (NBC) and some further accounts in the Foreign Trade Bank (FTB). These accounts cover both current and capital budget revenues and expenditures. The NT manages some of the accounts in the NBC, while some others (foreign exchange accounts) are outside its control. The special accounts for some of the donor funds are maintained in the NBC, though these also remain outside the NT control. The NT, however, consolidates all the financial accounts of the government, including the operations of the government bank accounts outside its control in the NBC. In the absence of any independent oversight system, the accuracy of the financial information on these bank accounts cannot be verified. In the case of accounts outside the control of the Treasury, it was not clear if these accounts were being reconciled in a timely manner. This is a huge source of non transparent management.

77. The NBC provides the NT with the daily balance in the main TSA. The NBC does not seem to play any other role in liquidity management. Some other government deposits seem to be operated on instruction from other authorities in the government. The cash inflow in the NT is received from many sources money collected directly by the tax departments and remitted to the NT; cash deposited in the

⁴ Financial management arrangements for the communes are addressed in Chapter 6.

NT or the provincial treasury; cash deposited directly in the NBC; cash deposit by the private sector and public sector autonomous agencies in the NT on account of dues to the government; and foreign currency deposits by the external donors for project funds. In addition, the government holds many US dollars denominated accounts in the NBC from the revenues collected in US dollars.

Analysis

78. The NT organization and functions, in theory, provide a strong institutional framework for efficient management of cash in Cambodia. However, in practice this has not taken place. There are no policies and procedures that require revenue collection agencies to transfer funds to NT on a regular basis. Line ministries that collect revenues retain them as long as they could. Tax and customs revenues are accounted in the NT only after collecting departments deposit them with NT.. There is no requirement for large tax payers to pay taxes directly to the TSA. Forestry revenue collection is another area where misuse of funds were reported recently. Lack of a revenue forecasting system and lack of automated information systems in collecting agencies and NT have weakened the ability of NT to effectively manage cash inflows.

79. Some of the basic system that should underpin any financial management system are completely absent from the NT. There are no standards to govern the treasury operations or public sector accounting, except some decrees and ad hoc circulars issued from time to time; no audit and no requirement to audit the accounts; and no automation with voluminous accounting transactions is being carried out by using hand-held calculators or manually. As in the case of most procedures governing financial operations in Cambodia, the focus of the NT remains on compliance and control through multiple regulations and procedures. The problem is seriously compounded by the absence of regular audit either internal or external. Some oversight function is, however, performed by more than one unit in the government through physical inspections of the line agencies. According to anecdotal evidence, this has also resulted in rent-seeking behavior at different levels of financial control, thus encouraging the agencies to flout established rules. Excessive controls seem only to have resulted in strengthening these systematic aberrations. There is also a serious capacity problem of lack of basic skills. This is reflected in constant revision to the accounting data during the year.

80. The third component of the explanation is the lack of an automated data recording system in both the NT and its provincial branches. Although provincial cash balances are reported daily, the accuracy of this data is questionable. Book balances and cash flows are rarely reconciled with stocks of cash. Thus, the lack of a reliable information system is a major obstacle to efficient cash management. The situation in the provincial treasuries are very much the same with all of the transactions taking place in cash. Provincial treasuries are responsible for payment of salaries for government workers, particularly teachers and health workers. There was one reported case of fraud in the Kampong Speu province. This demonstrate the risk of misappropriation due to cash based payment practices. Cash shortage thus results from a vicious cycle: agencies are not sure of adequate cash allocation and retain cash; and because agencies retain cash, the NT does not have enough cash.

81. The above deficiencies have resulted in a system which is not only inefficient but also lends itself to rent seeking. Lack of transparent procedures to allocate available cash and predominantly cash based collection and payment systems allow opportunities for corruption and misuse of funds. IMF has recommended establishment of a Treasury Single Account (TSA) with the NBC to conduct NT financial transactions. A TSA was established and used for deposit of government revenues in Riel, TSA is not used for payment of suppliers and no payment checks are issued. Instead NT withdraws cash from TSA and brings into NT for payment of creditors in cash.

82. Further, fragmentation of funds occurs because the Government's *foreign exchange reserves are not under the control of the NT*. The MEF's Foreign Currency Unit (FCU) is responsible for managing foreign currency revenues, although the law requires that foreign currency earnings be

deposited with NBC and converted to Riel, which does not happen. Foreign currency accounts typically have enough resources to meet current obligations, but remain unused to fund the budget in times of Riel shortages. Thus, there are no transparent rules for management of the foreign currency accounts. At the time of the visit of the mission at the end of July, NT did not have sufficient funds in Riel for payment of July salaries. However, the balances in the foreign currency accounts maintained by MEF's Foreign Currency Unit far exceeded the months requirements of salary payments.

83. Treasury's weak control over revenue collection provides only part of the explanation for the severe cash management problem. Another part of the problem is a result of *poor coordination between Treasury and MEF's Budget Management Department in the allocation of cash* to fund the budget. Although RGC established a Cash Management Committee (CMC) chaired by the MEF's BMD, CMC does not seem to have had much influence on cash management by the NT as yet. One of the more serious flaws in the current system is the lack of institutional coordination in the MEF. Organizationally, the NT is a part of the MEF. In reality, however, it does not generally take directions from the MEF. There is a near absence of formal information flows for managerial purposes between the NT and other departments in the MEF (especially the budget department). The NT does, however, provide some consolidated accounting information for statistical and external reporting purposes to the MEF. Decisions to allocate cash are made by the NT without apparent reference to either budget priorities (see section on PAP below) or payroll obligations. Indeed, the process by which the NT allocates cash to budget heads is unclear (some payment orders are paid immediately, while others are delayed until cash becomes available). The government faces severe cash shortages due weak controls in revenue collection. It is unclear how the NT allocates available cash resources to fund government obligations. When payment orders are received at the NT, they are paid if cash is available or left unpaid until cash becomes available. NT has an accounting of unpaid bills only of those suppliers that maintain deposit accounts with NT. The other unpaid bills are not recorded.

84. There are other avoidable distortions in the system that affects cash management. The budget is approved before the end of the fiscal year (calendar year). But the regulations governing authorization to spend are issued after the beginning of the fiscal year. The proper financing of the budget starts only around the beginning of February or later. There is a complementary period, which sometimes extends unofficially into the second quarter, when the accounts of the previous year are kept open by the MEF to clear payment for goods and services received but not paid for by the end of the previous year. The line agencies use this complementary period to spend money from the unspent balances in their budget allocations by accounting for these expenditures in the previous year. This distorts the picture of actual spending both in the previous and the following year. Owing to delays in adjusting the previous year's accounts, expenditures incurred in the previous year are also sometimes adjusted against the next year's allocation, affecting the agency budgets for the next year.

85. The main features driving the current situation of cash shortage are: (i) The distrust among various agencies (MEF, line agencies, tax departments); (ii) A feeling that the budget of the line agencies will not be fully financed in a timely manner; and (iii) A distribution problem due to cash retention in revenue surplus provinces. The distrust of the system is based on nontransparent allocation of cash. The line agencies know that the annual or the monthly cash plans prepared by them have little impact in the actual allocation of cash. The mission also heard anecdotal evidence from the line agencies of the incentives in the system to ensure adequate cash allocation. Cash shortage thus results from a vicious cycle: agencies are not sure of adequate cash allocation and retain cash; and because agencies retain cash, the NT does not have enough cash.

86. The MEF has also accepted that the approved budget will not be fully financed and this is reflected in its decision to establish a parallel system for financing the priority expenditure (PAP) in four ministries: health, education, agriculture and rural development. There are other systems, such as the ADD, to ensure adequate financing for some other priority programs. The result is that the line agencies not covered by these special financing systems are convinced that the flow of even partial

financing of their budgets will be uneven and uncertain. This has resulted in a great incentive for line agencies, including the provincial treasury to retain government revenues that should have been deposited in the NT. Under the current rules, revenue is to be remitted to the NT by the line agencies as soon as it is collected. Owing to the lack of banking system and logistical problems of cash distribution, the NT allows line agencies to retain cash for their projected liquidity needs. In practice, however, the line agencies tend to retain a major part of the revenue collected by them unless forced to deposit it in the NT.

87. With all the above weaknesses, the government has managed to avoid serious budget deficits or excessive domestic borrowing. This is a mystery that baffles many analysts. Unpaid accounts recorded in the accounting system (equivalent of domestic borrowing) at the end of July 2002 amounted to 168,426 million Riels (US\$ 43.2 million). This amount may be understated as these reflect debts to those suppliers who maintain deposit accounts. But the understatement may not be that material. The explanation of the phenomena is more likely to be that many cash transactions both revenue and expenses are off budget, that is line agencies retaining revenue to meet expenditures. In addition, NT releases payments only as revenue flows thereby avoiding serious deficit spending. Although, expenditure authorizations are made without reference to cash availability, it is likely that suppliers do not honor purchase orders when payment backlog build up. This probably is the cause of back-loading or under spending of the budget.

Recommendations:

88. The Government adopted two measures recently on the recommendation of the IMF in an attempt to improve control of revenue collections and expenditures. The RGC established a Treasury Single Account (TSA) in the NBC to conduct NT financial transactions. Some revenues in Riel are being deposited in the account and progress is being made. However, the TSA is not used to pay suppliers by either check or transfer. Rather, the NT withdraws cash from the TSA and injects it into the Treasury to pay creditors in cash.

89. The requirement that all government revenues should be deposited in the NT and all payments are centralized in NT should provide the basic foundation for efficient cash management. Under the budget execution model proposed, the periodic cash allocation function could be assigned to the Cash Management Committee (CMC) who will regularly review forecast of cash inflows and issue cash allocations to the spending ministries. Clear rules could be established for allocating limited cash to spending ministries. The transfer of current cash allocation authority from the NT to CMC would increase the transparency of this function as well as provide more certainty to the spending ministries.

90. The IMF Report makes number of recommendations to reform treasury operations and improve cash management. Some of these, such as the Cash Management Committee, opening of Treasury Single Account and stock taking of domestic debt (payment in arrear) have been completed. However, as noted above these measures needs further strengthening to be fully effective. The mission recommends that the following actions be under taken to move forward with the reform program:

- Issue a directive requiring all payments above an agreed amount (the law states Riels 2.5 million) be made only by check or bank transfer.
- Issue a directive requiring all large tax payers to pay taxes directly to TSA.
- Issue guidelines for revenue collection agencies on deposit of revenues to TSA within specified time limit of collection.
- Establish a simple computer system to record all financial transactions in the NT and provincial treasuries.
- Integrate management of foreign currency accounts to NT in accordance with the law.
- Improve coordination between National Treasury and Budget department of MEF by empowering Cash Management Committee.

- Require all spending units to submit quarterly cash forecast to Cash Management Committee and update them monthly.
- Require all cash transaction to be channeled through Treasury Single Account.
- Improve management information by automation National Treasury and Provincial Treasury transaction.

91. In making recommendations for reforming the treasury system, the mission was guided by the main objective of ensuring that the NT is the only manager of the government accounts so that it can manage all financial and non-financial assets and liabilities of the government. One of the most important structural reforms should thus be to move the NT away from its primary role as the banker to the government, and gradually devolve this role to the commercial banking system as the commercial banking sector improves with better regulatory framework including banking supervision. The NT should: (i) Control, manage, and account for all inflows and outflows in the government's accounts in order to ensure government resources are managed in a unified fashion to gain the maximum return; (ii) Manage all government financial and non-financial assets and liabilities (including domestic and external debt); (iii) Prepare the final accounts of government; present these accounts to the National Audit Authority; and present the audited accounts to the National Assembly for approval.

PUBLIC ACCOUNTING AND REPORTING

92. The financial accounting system has evolved over the years and is primarily based on French accounting principles. However, over time, other accounting conventions have been adopted either due ideological reasons (soviet conventions during Khmer Rouge regime) or to respond to changing fiscal management requirements. The system, as currently practice, does not meet with any acceptable accounting standards and does not provide accurate and timely information required for financial management of a modern state. Over time the system has deteriorated owing to the successive crises and incompatible systems imposed on this basic model. The lack of attention given to the system over the year has led to an inability to respond to the increasing and changing demands of budget management in particular, because basic constitutional systems such as a standardized accounting methodology do not exist. Also, the system is manual, and there is an extremely low level of automation in the National and provincial treasury. The result is the system that provides late, incomplete and inaccurate information.

93. The financial management was ranked as the third most important area in need of improvement by a questionnaire survey for implementing agencies (behind project management and planning and programming) at the Country Portfolio Performance Review (CPPR) workshop which was held in August 2000. The financial management capacity of the Project implementing Agencies suffer in three dimensions. First, the national procedures for budget preparation are weak and the overall financial situation makes the availability of counterpart funds a constant challenge. Second, Bank financial management procedures are poorly understood and not easy to deal with. Third, as project are decentralized into the regions and local areas, the issues mentioned above are simply compounded, unless there are simple and clear systems that can be taught quickly and coherently, as through the institute of Economics and Finance. The financial management systems across all agencies is very weak. There are lack of training, coherent and consistent policies, procedures and guidelines in all aspects of financial management and internal control systems. Of particular concern is the lack of common accounting procedure for World Bank projects in Cambodia. Closely linked to this is the lack of training and training manuals and lack of assistance when important financial management issues are raised. The focus group concluded that improving financial management skills was the most important area of concern to national and local implementing agencies.

Public Accounting

94. The Cambodian financial accounting is centralized in the NT and its provincial branches. There are no accounting records maintained at the line ministries or at the other branches of MEF. The Chart of Accounts used is highly aggregated, basically showing control accounts with very little or no subsidiary ledgers for analysis. A trial balance is produced monthly but no financial statements are produced. There is no accounting manual detailing policies, procedures and rules except for several decrees or sub-decrees that govern expenditure management.

95. The financial management of the government is based on regulations that establish principles for public finance management, most importantly the separation of ordonnateurs and public accountants in charge of payment. They define powers, obligations, and accountability for the public officials in budget execution and divided the process into two distinct stages:

- The administrative phase involving ordonnateurs in line ministries and the budget department in MEF.
- The accounting and payment phases involving the treasury and the Foreign Currency Management Unit from the MEF.

96. The focus of the accounting and reporting system is firmly on the final encashment stage of payment. All government transactions are meant to flow through this system. However, the reality of the situation is that line ministries retain many revenues and spent outside of this formal system.

Public Chart of Accounts

97. The current Public Chart of Accounts was initially established by a 1994 Prakah, the initial objective was to precisely identify services, location, and nature of budget operations through a specific system of budget codification. This codification has, however, been undermined and abandoned under subsequent finance laws. Currently, the Public Chart of Accounts consists of 63 accounts updated on March 19, 2001, for the state and four accounts updated on August 31, 2000 for the province. Some suppressed accounts, continue to be used, particularly in the provinces. There are two main types of budgetary accounts, which do not contain detail on individual transactions:

- Account N0 900 (revenue of state at central and provincial level) and 902 (province) to record total budgetary revenue; and
- Accounts N0 910 (expenditure of state at central and provincial level) and 912 (province) to record total budgetary expense.

98. Most operational accounts are either transfer accounts or entity accounts. Accounting procedures for recording transactions are not defined by any standard guidelines or methodology and are therefore open to different interpretations in different provinces.

99. Accounting information is compiled by the Treasury from manually recorded individual transactions into intermediate aggregations, which are consolidated on excel worksheets into monthly central and provincial balances. These activities result in the final account balance (balance generale des comptes du tesor) for the year and form the basis of the Loi de Règlement (Finance Law on final budget execution), which is approved by the National Assembly, usually four or five months after the end of the year. Before spending, the availability of budget allotments is also controlled through a manual register. Payment orders and other transactions are aggregated in hand-written daily trial balances. These daily balances are then summarized in the ledger. The semi-automated ledger aggregates the daily operations on a monthly basis with a separate reference to the account number.

Reporting

100. The main financial statement (called TOFE- Table of State Financial Operations) for expenditure management is produced by the Budget Department of MEF. The TOFE is produced based on information supplied by NT. However, there is no reconciliation between the TOFE and the ledger balances maintained by NT on revenue or expenditure accounts. The TOFE is the only report meant mainly for external users (such as IMF) and is of little internal practical use. This is compiled in the MEF from the information provided by Treasury monthly balances. It is highly aggregated and shows above-the-line information at the chapter level; it does not disaggregate by economic classification or functional unit.

Analysis

101. The basic objective of public finance accounting is to provide comprehensive, timely and accurate financial information on the financial position of the government by recording budget execution and revenue collection transactions in accordance with the established accounting system and procedures. The accounting system should:

- Be comprehensive and capture all transaction of the public sector, recording each transaction, inflow and outflow, assets, liabilities, incomes, and expenditure to comply with legal and other requirements using a standard and internationally accepted accounting methodology.
- Provide information on a daily and as needed basis and by transaction, and by any other analytical format.
- Enable managerial analysis to ensure that funds are used efficiently and effectively.
- Produce timely, accurate, and comprehensive financial accounting statements for information and effective control of finance.
- Be an instrument for management of cash by the treasury; and
- Maintain the bookkeeping for bank account of the government at the NBC.

102. Judged against these principles, the current system in Cambodia falls short in a number of dimensions. The combination of computerized and hand-written systems, an obsolete methodology, and the lack of precision from an outdated Chart of Accounts result in unreliable and partial information make it difficult to understand and verify the validity of fiscal information. The main shortcomings are:

103. ***Incomplete information:*** The recording system generates monthly balances five days after the close of every month. However, this information is limited to the operations carried out by the Treasury, and it does not contain detail on transactions outside of its control, for example, transactions carried out with cash retained by line ministries and through the extra budgetary funds (e.g. the road maintenance fund).

104. ***Unreliable information:*** The mission reviewed accounting records maintained both at NT and provincial treasuries. The mission concludes that the Chart of Account is inadequate to reflect all government financial transactions (assets, liabilities, bank and cash accounts, revenues, expenses, end-of-year results), the information is unreliable due lack of reconciliation and incomplete recording of all government transactions (e.g. foreign bank accounts maintained at MEF), and the accounts are not subject to independent audit. Given the above, it's the conclusion of the mission that the accounting system cannot be relied upon to provide any assurance that public funds are used for purposes intended.

105. ***Lack of Detail:*** The accounting system does not provide easily accessible information on individual transactions. Most accounting data is confined to aggregate information in various tables,

manual trial balances, and balance sheets not directly from accounting registers of individual transactions. The aggregates refer to different accounting documents and complementary tables are needed for consolidation. This restricts the ability of the system to provide adequately detailed management information.

106. ***Lack of Reconciliation:*** There is a lack of basic reconciliation systems to verify to accuracy of the information held within the accounting system. Whilst information is held at an aggregate level on revenue collection there is no reconciliation between the Treasuries and Revenue Collecting Departments on the detailed composition of the flows to the Treasury Line department keep records of their expenditure, but these are not reconciled at any point with the accounting records in the Treasury Line ministry records of expenditure are not reconciled with MEF/Treasury information to develop agreed records of expenditure reports. There is no systemic reconciling of accounting information with the banking sector. In the case of advance payments made by the treasury for programs under the PAP, the advance is adjusted on the basis of expenditure accounts rendered by the Budget Management Centers. It was, however, not very clear to the mission if the Treasury played any significant role in the scrutiny of these accounts beyond compiling these.

107. ***Financial Reporting does not facilitate public sector management:*** The result of the weaknesses in the accounting system is that expenditure reporting (TOFE) does not provide sufficiently accurate or detailed information for effective implementation. Information is provided by chapter without detail on the functional source of the activity, this is to a certain extent a function of the mismatch between the existing budget classification and Chart of Accounts structure. The reporting system, does not allow the MEF to identify on a timely basis the volume or source of current and future expenditure pressures. These functions are important to enable effective cash management. The lags and inaccuracies in the system mean that reports are often revised substantially throughout the year.

108. Unfortunately, the problems are myriad. First, the system is centralized in the NT and its provincial branches, and there are no accounting records maintained either by the line ministries or other MEF departments. Second, the chart of accounts is highly aggregated, basically showing control accounts with very little or no subsidiary ledgers for analysis. Third, though a trial balance is produced monthly, no financial statements are produced. Fourth, there is no accounting manual that details policies, procedures, or rules with the exception of several decrees and sub-decrees that govern expenditure management. Fifth, the TOFE (Table of State Financial Operations), which is the main financial statement for expenditure management, is produced by the EFPPMU based on data supplied by the NT, though there is no reconciliation between the TOFE and the ledger balances maintained by the NT on revenue or expenditure accounts.

109. Given the severity of the problems the inadequacy of the chart of accounts for reflecting all government financial transactions (assets, liabilities, bank and cash accounts, revenues, expenses, end-of-year results), the unreliability of basic information due to the lack of reconciliation and incomplete recording of all government transactions (e.g., foreign bank accounts maintained at MEF), and the fact that accounts are not subject to independent audit—it must be concluded that the accounting system cannot be relied upon to provide assurance that public funds are used for the purposes intended. Though a Treasury Accounting Working Group has been formed to address these problems, progress has been slow. *Addressing the lack of uniform accounting policies and procedures as well as the lack of adequate systems for timely and accurate data recording and reporting should be considered the two most urgent initiatives.*

Recommendations

110. As most government transactions relate to revenue collections and payment of recurrent costs, devising accounting policies and procedures should not involve adopting all the currently available

international public accounting standards. The accounting working group should be required to review the relevant standards and come up with simple and clear policies and rules without getting too involved with complex issues that may have only distant future applicability.

111. Although an integrated financial management system should be the ultimate goal, the technical competency of staff and current development of accounting rules and regulations do not warrant embarking on a complex system for the time being. A computer system should be installed to computerize accounting transactions. At the NT, where bulk of the transactions take place, an integrated software package could be installed to undertake all transactions. For provincial treasury operations, a stand alone PC with a single user capability is more than adequate. Data transfer from provincial treasuries to NT system could be through disks (as currently practiced in some of the Bank's projects with provincial operations).

112. The basic principles underlying the recommendations for the accounting and financial reporting system are to establish a system that closely links budgeting, spending, and reporting within a standardized single accounting framework. At the same time, it should be rationalized and computerized by the recording of each transaction in a ledger (general and subsidiary) based system, item by item, in order to establish trial balance and balance sheets in accordance with established rules. In the medium term, these reforms will also improve the effectiveness of the National Audit Authority. A concurrent step should be to improve the quantity, quality and timeliness of information by designing a system of financial reporting. Certain immediate steps need to be taken. These are:

- Accounting system should be reviewed to ensure that the distortions such as netting are disallowed.
- Accounts capture all the transactions; all inflows and outflows in the public sector.
- Compilation of accounts follow a standard system that are consistent with generally accepted accounting principles so that the accuracy of information is ensured; and
- The accounts are timely.

113. ***Review and standardize the methodology for public sector accounting:*** Currently, the public accounting system in Cambodia does not follow a standardized international accounting system and methodology. It is guided by numerous ad hoc decrees, laws and instructions. In the process, many nontransparent accounting practices are been followed. Offsetting transactions, for example, mainly owing to the shortage of cash, has become a common feature of the money management system. Government tax dues from a private sector supplier are offset against his claims against the government. Apart from the fact that these transactions are nontransparent and result in the loss of detail, this practice can also result in the loss of revenues owing to the lack of transparency. Offsetting transactions should be completely avoided, and all flows should be treated distinctly. The money due to the government should be collected in a separate transaction and deposited in the NT. The payment due from the government should be paid as a distinct transaction. Offsetting is more than an accounting distortion; it affects both the transparency of operation and cash management.

114. ***Ensure comprehensive coverage by the public accounts:*** The public accounting system should record all the revenue and expenditure transactions, item by item, with supporting documents, including transactions in foreign currencies and user fees and charges for all government agencies. It is necessary to prepare an inventory of all the spending units supported by the budget and where budgetary inflows are collected. At the same time, it is important to document different types of transactions arising in the public sector and ensure that these are captured in the budget classification and the chart of accounts.

115. ***Review and standardize the Chart of Accounts:*** In a well structure classification system, the budget is organized in a program structure that provide identifying each item of expenditure under specific objectives of spending. Each function may, however, fall under more than one organizational category.

116. **Improvement of Reporting System:** The reporting system in Cambodia, should at the most basic level, be able to accomplish the following:

- Enable financial managers in the MEF and the spending agencies to control commitments and expenditures pressures to amounts that can be financed within budgetary resource availability.
- Utilize information provided on all stages of the budget execution system and by all agencies, record and track expenditure from appropriation, through commitment to payment by economic classification, functional unit, and program.
- Enable the MEF to prioritize cash allocation, especially in the case of development spending.
- Make an accurate forecast of all revenue inflows.

117. **Prepare a master plan for the integrated computerization of Budget Execution:** The mission understand that each line agency provides a monthly statement of above-the-line expenditures to the NT within five days of the end of the month. This is one of the strengths of the system. The monthly report should contain, in addition to budgetary spending, the following:

- All the commitments visas issued to the line agency under each budget line item.
- All the payment liability incurred where goods and services have been received but payment order has not been issued.
- Where request for commitment visa has been made but the visa has not been issued, and
- A projection of requests for the issue of commitment visas in the next three months.

118. This information should be received both for the recurrent and the investment budgets. This information should be sent to the NT and to the budget department, especially the Cash Management Unit. This will enable the NT and the budget department to assess the expenditure pressures in the next three months and prioritize the spending accordingly.

119. **Improve the skill level of accounting staff:** Reinforcement of management capacity in the National and Provincial Treasuries is an essential prerequisite for improving public finance management in Cambodia. In the short term, the mission recommends an implementation of basic level of automation for the National Treasury and Provincial Treasury, this will involve computerization of the following specific functions:

- Production of general accounts balance by consolidation of central and provincial balances by central accounting office.
- Recording of each separate expenditure transaction in the expenditure office.
- Recording of each separate revenue transaction in the revenue office; and
- Recording of each separate cash operation in the cash office.

120. In the provincial treasury, the recording of all state and province budget transactions should be computerized. One important issue is that even basic computerization of the accounting system at the NT or its branches will require a coherent and consistent accounting policy and methodology. The current accounting framework and policy, which consists of many unorganized and seemingly ad hoc accounting directives issued from time to time, need to be reviewed and put together in a coherent framework. The basic framework of such an accounting policy should be developed following generally accepted accounting principles.

121. Technical assistance was provided under an IMF program and ADB. However, the progress of reform is very slow and nothing of significance have been achieved since commencement of TA some twelve months ago. The mission is of the opinion that the Accounting Reform Group set up to steer the reform program is involved in trying to resolve too many theoretical and practical issues which has

bogged down the reform effort. The mission proposed a very pragmatic approach to get the reform program on track. This would involve paying attention to basic principles and accuracy of information before tackling more complex issue of accounting principles and standards.

122. The main objective of the first phase of the reform program should be to produce accurate accounting information based on a unified chart of accounts. There should be no changes to the current budget classification, budget execution rules or the payment system. Based on the above assumption, the following implementation program is recommended:

- Require Treasury Accounting Working Group to establish an acceptable set of accounting policies and procedures to be used in preparation of government financial statements. These principles and procedures could be based on international public accounting standards but adopted to suit conditions currently prevalent in Cambodia;
- The Working Group to submit a revised chart of accounts combining the current budget classification coding of revenue and expenditure and treasury accounts and expanding the asset and liability accounts to include all government transactions.
- Develop a simple accounting manual fully explaining the linkage of new chart of accounts to budget classifications and providing clear rules for coding of financial transactions.
- Require that all government financial statements are generated through the computer system.
- Addressing the lack of uniform accounting policies and procedures and lack of adequate systems for timely and accurate data production are the two most urgent weaknesses that need urgent attention. As most government transactions relate to revenue collections and payment of recurrent costs, devising accounting policies and procedures should not involve adopting all the currently available international public accounting standards. The Accounting Working Group should be required to review the relevant standards and come up with simple and clear policies and rules without getting too involved with complex issues that may have only distant future applicability.

123. Although an integrated financial management system should be the ultimate goal, the technical competency of staff and current development of accounting rules and regulations do not warrant embarking on a complex system for the time being. The Bank has successfully assisted in installing stand alone PC based computerized accounting systems for project accounting in Cambodia. These systems have used simple software (such as Peachtree) or more complex software (such as Solomons) and are operated by trained Cambodian staff. A more complex project, such as the Flood Emergency Rehabilitation Project, uses Solomons software and is operated by Cambodian staff with the assistance of one expatriate accountant.

124. For provincial treasury operations, a stand alone PC with a single user capability is more than adequate. Two or three person team could be trained to operate the system with support from NT. Data transfer from provincial treasuries to NT system could be through disks, as currently practiced in some of the Bank projects with provincial operations.

AUDITING

125. The function of control of the public expenditures is still premature. It subsists the organizational and coordination deficiencies between the different structures intervening in the internal and external controls. The annual accounts of the government are not audited and certified to be correct. There are also no private sector auditors, though there are some international audit firms mainly to audit the accounts of the multinationals operating in Cambodia.

External Audit

126. Though there has been progress in improving the audit function, the public oversight of government financial management remains extremely weak. While there is a banking and finance committee in the National Assembly, it is unclear to what extent the committee is active in overseeing government finances. For example, though the TOFE is submitted to the committee, it does not appear that the committee publishes its deliberations. As Cambodia does not publish government financial statements or audit reports, there is a complete absence of public debate on government financial affairs. The National Assembly doesn't exercise in practice any control on the public finances and that the finance section has a very limited human and material resources.

127. The government passed a law CS/RKM/0300/10 in January 2000 establishing a National Audit Authority (NAA). The NAA is independent of the executive branch of the government and is empowered to carry out external auditing function of the government. The law provides an appointment of an Auditor-General and two Deputy Auditor-Generals by Royal Decree at the recommendation of the Government and approved by a two-third majority vote of the whole National Assembly members. The Auditor-General shall have a rank and privilege equivalent to that of a Senior Minister. The legal foundation of the NAA is sound and is consistent with good international practice. The financial independence of the NAA and its authority to determine the scope of audits are guaranteed by law. The law also requires that each internal audit unit of government departments shall report its finding to the NAA.

128. The NAA is responsible for executing the external auditing function of the Government. The Auditor General should be empowered to conduct an audit of transactions, accounts, controls, operations, and programs of government institutions, in accordance with generally accepted auditing standards. This includes the National Treasury, all ministries, public financial institutions, municipalities, provincial and contractors or other organizations that have received financial assistance from the government. According to the law, the NAA is an independent, public entity and shall report directly to the National Assembly, Senate and the Government (for purpose of giving information). The reports issued by the Auditor General shall be considered as a public documents. The NAA has its own separate budget provided by the National Budget.

129. NAA staff are hired on higher salaries than that paid to civil servants. This has enabled NAA to attract quality staff and require higher ethical standards from its staff. However, NAA acknowledges that a considerable amount of on-the-job training is required for it to be fully effective. As a young organization with a mission to accomplish, NAA appears to be well motivated. The NAA is fully staffed (100) and became operational at the beginning of the year 2002. The staff of the NAA has its own separate statute. This superior institution has to be not only competent concerning judgment of the accounts but also on the judgment of the regularity and the quality of the management of the authorizing officers. Staff recruited to NAA will need to develop skills in conducting financial performance and compliance audits. Audit manuals for performance and compliance auditing will be developed to help staff to conduct such evaluations. Audit procedures for reporting and administration will also be developed under the ADB technical assistance.

130. NAA is not yet on the radar screens of many of the donors. NAA badly needs technical assistance to upgrade its staff skills and provide it with equipment (computers/laptops) to effectively carry out its duties. Under the original program put together by ADB, training in theory and practice spanning 12 and 16 months respectively were planned. However, due lack of TA resources, this has not taken place. Actually, the external control is almost non-existent because the NAA doesn't have competent and well trained staff who can assume these responsibilities. There is an urgent need for donor funding of training activities and equipping of NAA.

131. The NAA carried out an audit of the year 2001 budget implementation as its first audit assignment. The audit was completed in September 2002. A report was issued to National Assembly but this is not yet published. As its first audit report is yet to be published, it is not proper to make any judgments on capacity of NAA.

Internal Audit

132. The Public Expenditure Management System in Cambodia are excessively compliance oriented. There is a unit in the MEF that monitors compliance through periodic on the spots visits to the various units. This unit, however, does not follow a standard internal audit system, which though internal to the MEF, is an external unit for the line agencies. There is no internal audit system in Cambodia, and there is a need to establish internal audit capacity in the line agencies, especially as the authorities plan to delegate greater expenditure management to the line agencies. There is also a need to start to prepare a manual for internal audit, the hierarchical and reporting relationship of internal audit unit in the line agencies, audit calendar and strategy, and training of the audit staff.

133. The internal control is represented in Cambodia by the internal auditing function and the Department of Financial Inspection (DFI). According to the law CS/RKM/0300/10 of January 13, 2000, the Internal Audit Department shall be established within each ministry and state enterprises. The internal audit department shall report to its head of ministry, institution and shall submit its report and conclusion to the National Audit Authority (NAA). However, according to the NAA, there is no report submitted to them from the Internal Control Department.

Analysis

134. The ADB technical assistance is supposed to design the communication and information flows between the Auditor General's Office and internal audit in line ministries, the Finance and Banking Commission of the National Assembly, DFI, provincial governments and agencies, and the Ministry of the National Assembly-Senate Relations and Inspection. The TA will focus on developing the framework within MEF and MOH for effective internal auditing. By having an effective internal audit function, management in a ministry is assured that the control framework is adequate and is working as intended. NAA, by reviewing the work performed by the internal auditor, can form an opinion on the adequacy and quality of the internal audit work done. Where the external auditor is satisfied that the work of internal audit meets professional standards, the external auditor can then rely on this work and reduce the extent of review that is required. If this pilot test is successful, the concept and methodologies can be extended to the other line ministries and state enterprises as a model to be followed. NAA's effectiveness in the longer term will be enhanced.

135. In addition, a framework will be developed for strengthening the Finance and Banking Commission (FBC) of the National Assembly. This will include streamlining the reporting process between NAA and FBC and preparing a mandate to enable FBC to function as a key participant in the framework of accountability. FBC's role will be expanded to establish a closer working relationship with NAA in the areas of audit planning, budget funding and following up key audit findings. The activity will build on training to be provided by the Canadian international Development Agency (CIDA). FBC can be a conduit for dialogue between NAA and parliament; have a clear role in the method of selecting and appointing the auditor general and deputy auditor generals; and enhance the auditor general's independence by supporting the auditor general's requests for budget funding to parliament and ensuring that the office of the auditor general is made accountable for its activities.

Recommendations

136. The government has also embarked upon creating internal audit units in key ministries. The mission believe that internal auditing is an important function required to improve internal control

environment of the line ministries. However, this is not a priority at the moment as government capacity to manage multiple improvement activities is limited. This effort is undertaken due donor pressure and is another case where the government undertake more than it can handle. Government's scarce resources are better spent in strengthening NAA at this stage.

137. With the establishment of the NAA, the role of MEF's DFI will be redefined. DFI could be the internal auditor for MEF and could monitor the implementation of the budget of agencies funded by the Government's budget. It is thus essential that DFI be given a clear role, recognizing the responsibilities of NAA, internal audit, and the National Assembly-Senate Relation and Inspection. To effectively perform in its new role, DFI will require further training and methodologies to be developed for internal audit and budget inspection. The TA will help DFI develop an internal audit charter and manual of procedures, a budget inspection manual, and staff training.

138. The NAA is fully staffed and became operational in early 2002. The NAA completed an audit of the 2001 budget in September 2002 and issued its report to the National Assembly. The report has not yet been made public, but it is imperative that NAA reports become public documents after approval by the National Assembly. In 2003 the NAA is programmed to carry out nine audits of public bodies, including provinces, communes, and line departments. The NAA seems to be moving forward purposefully, yet it is clear that a considerable amount of on-the-job training and technical assistance will be required for it to be fully effective.

RECOMMENDATIONS SUMMARY

139. The government has embraced many reform initiatives sponsored by its development partners. These include major initiatives such as performance based budgeting, budget decentralization, medium-term budget framework, standardization of accounting, treasury reforms and many others. The agenda is totally beyond government capacity and misses fundamental weaknesses particularly in the payment and reporting system. Therefore, it is in the intention of this report not to add to this long list but provide a framework for step-by-step approach to reform starting with the most basic.

140. The mission opines that reliable, accurate and timely information is the foundation of any meaningful fiscal management improvement program. Therefore, the mission recommends that the government focus on building this foundation as the first priority. This should be accomplished without making any fundamental changes to the current budget execution system or the payment system.

141. The following is a summary of the mission's recommendations:

142. Budget Process

- Evaluate the operational efficiency, compliance, and performance of PAP by undertaking a review and tracking survey before further expansion (focusing on education, health, and agriculture) in order to gradually eliminate current multiple procedures.
- Refine job descriptions, institutional arrangements, and authorization procedures for outposted financial controllers.
- Outpost all financial controllers from the Budget and Financial Affairs Department (BFAD) to the spending ministries.⁵

143. Treasury Management

- Define and apply threshold for National and Provincial Treasury expenditure operations to be executed by check or bank transfer, and use the banking system for all intragovernmental transfers.

⁵ Reform underway: financial controllers outposted to MOH and MOEYS.

- Issue a directive requiring all payments above an agreed amount (law states CR 2.5 million) be made only by check or bank transfer;
- Issue a directive requiring all large tax payers to pay taxes directly to Treasury Single Account with the National Bank;
- Undertake an inventory of all revenue accounts and draw up a schedule for the elimination of revenue retention accounts that have no legal basis and consolidate revenues into the Treasury Single Account with legal basis.
- Integrate management of foreign currency revenues to National Treasury in accordance with the law.
- Empower the Cash Management Committee to play a greater role in cash allocations to spending ministries

144. Public Accounting and Reporting

- Require Treasury Accounting Working Group to design accounting policies and procedures based on applicable international public accounting standards;
- Require Treasury Accounting Working Group to submit a revised chart of accounts combining the current budget classification coding of revenue and expenditure and treasury accounts and expanding the asset and liability accounts to include all government transactions.
- Develop a simple accounting manual fully explaining the linkage of new chart of accounts to budget classifications and providing clear rules for coding of financial transactions.
- Review requirements for computerization of National and Provincial Treasury operations.
- Train adequate staff in each of NT and provincial treasury offices in the computerized accounting system.
- Require that all government financial statements are generated through the computer system.

145. In order that the above reforms are managed efficiently, it is recommended that Priority Management Group be established with staff drawn from the National Treasury, Provincial Treasuries, MEF Budget and Financial Affairs Department and key line ministries. This group should work full time with assistance from external technical experts in implementing the above program.

146. Control Functions

- Establish an effective Parliamentary oversight on public finances by providing necessary training and equipment.
- Establish an effective internal audit function and control framework in line ministries.
- Strengthen the National Audit Authority by conducting training on International Auditing Standards and providing necessary equipment.
- Financial statements to be audited annually by the NAA.
- Publish audited financial statements and make them accessible to the public.

Appendix B

Cambodia - Country Financial Assessment Accountability

Prioritized list of Recommendation						
Objectives	Recommendation	Responsible Unit	Technical Assistance		Time Frame	
			Short Term 2003	Medium Term 2004-2005	Short Term 2003	Medium Term 2004-2005
1. For effective budget management.	a. Evaluate the operational efficiency, compliance, and performance of PAP by undertaking a review and tracking survey before further expansion (focusing on education, health, and agriculture) in order to gradually eliminate current multiple procedures.	MEF and NT			X	X
	b. Refine job descriptions, institutional arrangements, and authorization procedures for outposted financial controllers.	TOR for consultant to be drafted by the WB		X		X
	c. Outpost all financial controllers from the Budget and Financial Affairs Department (BFAD) to the spending ministries	MEF				X
2. To improve treasury operations and cash management.						
	a. Define and apply threshold for National and Provincial Treasury expenditure operations to be executed by check or bank transfer, and use the banking system for all intragovernmental transfers.	MEF and NT			X	
	b. Undertake an inventory of all revenue accounts and draw up a schedule for the elimination of revenue retention accounts that have no legal basis and consolidate revenues into the Treasury Single Account with legal basis.	MEF			X	X
	c. Integrate management of foreign currency revenues to NT.	MEF			X	
	d. Improve Cash Management Committee and bank account reconciliation processes.	MEF and NT	X		X	

Prioritized list of Recommendation

Objectives	Recommendation	Responsible Unit	Technical Assistance		Time Frame	
			Short Term 2003	Medium Term 2004-2005	Short Term 2003	Medium Term 2004-2005
3. To improve Government's financial accountability.	a. Revised Chart of Accounts combining the current budget classification and treasury accounts.	National Treasury	X		X	X
	b. Technical Assistance to be provided for computerization of National Treasury Operations and training.	NT and WB	X		X	X
	c. Prepare financial statements in accordance with adopted standards.	National Treasury	X			X
	d. Development of implementation plan for provincial treasuries.	NT and WB		X		X
4. To strengthen Government's control functions and transparency.	a. Establish an effective Parliamentary oversight on public finances.	National Assembly		X		X
	b. Establish an effective internal audit function and control framework in line ministries.	Line Ministries		X		X
	c. Strengthen the National Audit Authority (NAA) by conducting training of their staff on International Auditing standards and providing necessary equipment.	National Audit Authority	X		X	
	d. Financial statements to be audited annually by the Auditor General.	National Audit Authority			X	
	e. Publish audited financial statements and make them accessible to the public.	National Assembly			X	

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