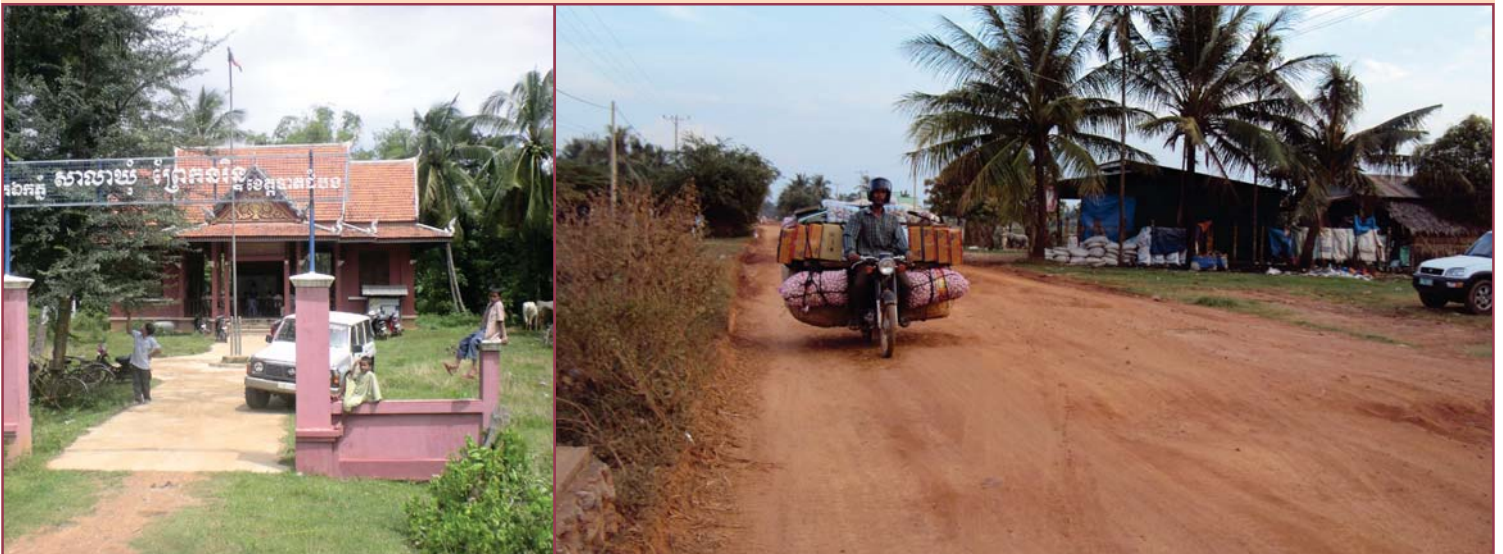




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# Fiscal Decentralisation in Cambodia: A Review of Progress and Challenges



**PAK Kimchoeun**

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Phnom Penh, May 2011

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PAK Kimchoeun

*The responsibility for opinions expressed in signed articles, studies and other contributions rests solely with the authors, and publication does not necessarily constitute an endorsement by CDRI.*

**Front cover photos:**

1. Fiscal decentralisation means that the commune council now has more concrete means to realise its promise to local people, Prek Norin commune office, Battambang province
2. People have a stronger sense of ownership of locally funded works: a well maintained rural road in Kampong Trach commune, Kampot province

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## List of Abbreviations

CSF	Commune/ <i>Sangkat</i> Fund
DIF	District Initiative Fund
D&D	Decentralisation and deconcentration
MEF	Ministry of Economy and Finance
NCDD	National Committee for Democratic Development
NP-SNDD	National Programme for Sub-National Democratic Development
PFMRP	Public Financial Management Reform Programme
PIF	Provincial Investment Fund
SNA	Sub-national administrations

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## Abstract

To achieve democratic development, Cambodia's next step towards fiscal decentralisation will focus on both institutional and service delivery reform at district level so as to strengthen the capacity of the sub-national administration and better link it to sectoral service delivery. To move forwards, fiscal decentralisation needs to be comprehensive and well coordinated with other cross-cutting reforms, especially the Public Financial Management Reform Programme, and sectoral reforms. This does not mean that everything has to be done at the same time, for doing so would overwhelm existing capacity and go against the more gradual 'learning by doing' philosophy of Cambodia's decentralisation. Being comprehensive entails setting out the longer term vision, anticipating the kinds of challenges that lie ahead and planning realistic and flexible sequencing strategies.

Linking decentralisation to sectoral policy is particularly challenging – especially given the current centralised patronage-based process associated with sectoral service delivery and state budget management. The challenges are compounded by the parallel fragmented nature of donor support through numerous vertical projects. Overcoming them requires that fiscal decentralisation in the future should not be seen as mostly initiated and driven by the Ministry of the Interior, but rather by the sectors themselves. That donors be involved and supportive of decentralisation is no less important.

There are reasons for both optimism and pessimism about the next step of fiscal decentralisation under the Organic Law. On the one hand, successful experience with communes since 2002 engenders the strong hope that the government will again prove its adaptability and successfully navigate the reform. On the other hand, commune reform has barely touched on the kinds of tasks expected in the next step, namely functional assignment, revenue assignment, and more systematic inter-governmental transfer. Some basic components and tasks, including functional and revenue assignment, were hardly implemented under the commune reform. Starting on these tasks will definitely run into resistance from central agencies, a test that will prove how committed the government is to fiscal decentralisation.



# 1. Introduction, Objectives and Methodologies

Cambodia started its decentralisation reform with the commune/*sangkat* election in 2002. In 2007, another commune/*sangkat* election was held, followed by indirect election of provincial and district councils in May 2009. The reform has changed and will continue to change Cambodian political and administrative structures, with the hope that gradually it will strengthen accountability between the state and the people and promote better service delivery such as in education, health, agriculture and rural development.

Fiscal decentralisation, which is about transferring more functions and resources to sub-national authorities, is key to the reform. Without fiscal transfers, the reform would not improve political accountability and service delivery (RGC 2010a). That is why, along with the adoption of the Organic Law, the National Programme for Sub-National Democratic Development (NP-SNDD) and other key policy papers, the government and development partners have focused on drafting the Law on Financial Regime and Asset Management of Sub-National Administrations (hereafter referred to as Sub-National Finance Law) and other matters relating to fiscal transfers and budgetary management.

Fiscal decentralisation since 2002 has focused mainly on the Commune/*Sangkat* Fund (CSF). The next step of the reform, while still giving priority to communes, starts to give more attention to districts and municipalities (NCDD 2010a). Moreover, unlike the CSF and other funds—Provincial Investment Fund (PIF), District Initiative Fund (DIF)—which had been managed largely outside the mainstream national budget (Pak & Craig 2008), the next step is intended to better integrate sub-national budgets into the national budgetary system (RGC 2010a).

Fiscal decentralisation under the NP-SNDD calls for more engagement and coordination from other sectoral ministries, reform programmes, donors, civil society and the public. The involvement is required because fiscal decentralisation would not work without it. Of course, such engagement needs to be mandated by laws and policies. However, better understanding of fiscal decentralisation can also encourage more engagement with this complicated topic.

This paper aims to promote such understanding. It discusses Cambodia's fiscal decentralisation within an international conceptual framework. It reviews what has been achieved so far, what is planned to happen in the short and medium terms and the challenges the reform is likely to face. The paper is expected to be useful to policy makers, non-government organisations, researchers, university students and those interested in governance reform in Cambodia.

The paper seeks to make two related arguments relevant to fiscal decentralisation in coming years:

- The reform in the next step needs to be both wide-ranging institutional<sup>1</sup> reform and sectoral service delivery reform if it is to achieve both local development and democracy.

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<sup>1</sup> By “institutions”, this study means “organisation and procedures”, a simple definition used by the government (NCDD 2010b). This definition makes “institution” comparable to “governance system”.

- Given its expected breadth and depth, coordination and strategic sequencing are the most important elements in the process.

The two arguments imply that one needs to understand both the whole and the parts of the reform. It is not possible to focus only on the CSF or district roles in the new administrative set-up, nor is it possible to focus only on sectoral deconcentration. These activities need to be understood within a more coherent and well-sequenced policy aimed at achieving three simultaneous objectives, as mentioned in NCDD (2010c):

- producing collective and appropriate policy and legal and regulatory frameworks;
- developing institutions and related capacities;
- improving service delivery for local development and democracy.

This paper bases its analysis on both primary and secondary data. First, it analyses information from recent government legal and policy documents, including: the Strategic Framework for D&D (2005), the Organic Law (2008), the NP-SNDD (2010) and its annexes, the Three-Year Implementation Plan (2010) and other laws and policies including the Public Finance Law (2008), annual budget laws, Public Financial Management Reform Programme (PFMRP) (Phases I and II), and selective sectoral policies and budgetary information. Evaluation reports and research works were also reviewed.

Second, the paper also relies on primary data obtained through my experience researching decentralisation, governance reforms and public expenditure management since 2003. I also draw on observations and key informant interviews from my work as a consultant during the formulation of the NP-SNDD in late 2008 and early 2009.

Two specific limitations of the paper should be mentioned. First, it focuses more on an overview of the reform and does not go into more technical details. Second, the paper focuses only on the financial/ budgetary component, and not the transfers of assets and personnel.

## 2. Key Concepts

Usually, literature about fiscal decentralisation focuses on two related aspects: the components of the reform and the process by which the components can be established and put to use. The first is more technical, the second more managerial and political. The following discussion focuses on both. Because this is not a theoretical paper, it intends only to provide a guide for subsequent sections rather than to question theories or arguments.

Many countries are implementing fiscal decentralisation. The question is why they need such a policy. The simple theoretical explanation is that bringing government closer to the people and allowing local authorities to appropriate resources to meet demands flexibly can increase efficiency and downward accountability, improving local service delivery (Bahl 2009).

Improving local service delivery, as Blunt and Turner (2007) argue, is often under-emphasised in decentralisation debates, which tend to focus more on the democratic effect. Administrative decentralisation (i.e. “deconcentration”) has often been overlooked. Bahl and Blunt and Turner remind us that decentralisation is not just about local participatory planning, but also about getting basic services to people. To do that, meaningful fiscal decentralisation is of the greatest importance.

For both the political and service delivery objectives, the positive impacts of fiscal decentralisation have been more a promise than a reality (Bahl 2009). The promises can be realised only if the reform is well designed and implemented. Technically, this means putting a decentralised governance system in place, which is elaborated in the following section.

### 2.1. Key Components in Fiscal Decentralisation

Fiscal decentralisation has four main components: (1) functional transfers, (2) revenue transfers, (3) inter-governmental transfers and (4) local borrowing (Smoke 2001). The last point is irrelevant to Cambodia and will not be discussed. The paper will look at point (1) in section 2.1.1 and points (2) and (3) in section 2.1.2.

#### 2.1.1. *Functional Assignments*<sup>2</sup>

Basically, a function is a set of related activities that work within a larger system to produce a result that is beneficial to that system’s operation ... the result of a government function is a public good. A function can refer to either specific services (or sub-sectors) such as preschool education, rural road repair and maintenance, or to internal processes needed for delivering the services, such as planning, budgeting, procurement, monitoring and evaluation and training. Breaking down a function into its different parts is called “unbundling” and is important in a functional review.

A functional assignment is generally understood as both the assigning of functions and the result of that process, i.e. the actual location of functions. When a function is assigned to a sub-national administration (SNA), the latter is made accountable for the associated outputs and outcomes. This usually implies that the SNA will implement the function, but it does not exclude the possibility of other actors participating.

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2 This section is drawn mainly from GTZ (2009), Flam (2008) and World Bank (1998)

Technically, a number of criteria are used to decide which functions should be assigned to which tier of SNA. The principle of subsidiarity is the most important; it states that a function should be undertaken by the lowest level that can implement it efficiently and effectively. Another principle, economy of scale, argues that a function should be transferred to the administration that can deliver it at the lowest unit cost.

A function can be transferred in a decentralised (devolved), deconcentrated or delegated manner. When a function is decentralised, it is transferred to a SNA council. Deconcentration refers to a central agency transferring a function to its own administrative branches. Delegation exists when SNA councils or other service providers undertake to perform a function on behalf of a central line agency.

When a level of government is charged with providing a service, it does not follow that it needs to be directly involved in its production. It can choose to delegate or contract it out to non-government actors. However, the accountability for the function stills lies with the government level to which the function was assigned.

Functional transfer is long and complicated. It needs political buy-in and an agreed long-term vision of the roles of each tier of administration. The functions and their assignment need to be legally binding, i.e. stated explicitly in law. After the legal foundation is prepared, roundtable discussions with line ministries, donor agencies and SNAs are carried out. Within each ministry, a new decentralisation group is usually established for internal discussion about sectoral functional reviews and assignments (GTZ 2009).

### ***2.1.2. Revenue Assignment and Intergovernmental Transfers***

A key principle in fiscal decentralisation is “Finance follows functions” (Bahl 1999). This implies that when a function is transferred, consideration should be given to the resources that should follow to ensure the function is performed (Ferrazzi 2001). Resources include finances, personnel and assets. This paper focuses only on financial resources from a SNA’s tax and non-tax own source revenues and from national transfers.

Allowing SNAs to raise their own revenues is preferred for a number of reasons. First, when taxed, local people feel the burden and thus tend to be more vigilant in making sure that services they get in return are of good quality and meet their needs. This enhances local accountability. Second, SNAs are more likely to spend money more carefully if they have to go through difficulties collecting it (Bahl 1999).

However, in a post-conflict weak state like Cambodia, tax administration is particularly challenging (IMF 2004). For this reason, SNAs in those countries are usually allowed to collect only easily administered tax and non-tax revenues, such as motor taxes, property taxes and user charges (Bahl 1999). As administrative capacity improves, SNAs can be allowed to set their own tax rates, within limits (Bahl 2009).

Usually, SNAs in developing countries rely substantially on transfers from the central government (Bahl 2000). A transfer is a compromise between central government control over public financing and channelling funds to regions and localities. Its forms include grants, shared taxes and subsidies. Intergovernmental transfers’ objectives include vertical balancing of expenditure

and revenues, regional equalisation and efficiency (Bahl 2000). Addressing vertical imbalance and regional inequality are particularly relevant.

Vertical imbalance is the gap between the expenditure needs of a SNA and its revenue. Expenditure needs of a SNA can be measured by the “minimum service level”; based on that, the financial gap that needs to be filled by national transfers can be identified. However, using the minimum service level is too complicated at times, or it may dictate huge transfers (Bahl & Smoke 2003). Therefore, in some cases, the national transfer is determined simply by the budget constraints of the central government (Bahl 2000).

Equalisation means minimising regional fiscal disparities. Usually regions with a more prosperous economic situation can collect more local taxes. To equalise regional differences, inter-government transfer can be a good tool. Of course, whether equalisation is a good policy or whether it can be achieved depends very much on the details, e.g. what revenue source finances the transfer and which kinds of services are financed (Bahl 2000).

National transfers should be transparent and predictable. This is important to allow medium-term planning of service delivery by SNAs. One way to increase transparency and predictability is to use formula-based grants, allocated according to population, poverty index or similar objective criteria (Smoke 2007). It is also important to decide the right mix between conditional transfers (tied to specific services) and unconditional transfers (over which SNAs have high discretion) (Smoke 2007).

SNAs need to spend their funds in an accountable manner. This implies a public expenditure management system within the framework of the system-wide Public Financial Management Reform Programme (PFMRP) (UNCDF 2005). A balance needs to be sought here. It is reasonable for SNAs to comply with national budgeting processes and standards and to be accountable to the central government for the transfers they have received. On the other hand, SNA fiscal autonomy and downward accountability need to be maintained (Bahl 2000; UNCDF 2005).

Donor finance also acts as a transfer. Development or social funds have been used for years to help activities undertaken by SNAs. These funds are often transferred in parallel with the government transfer system, and thus insulated from common mainstream problems such as leakages and disbursement delays. The downside is the lack of integration into both the central and SNA financial management systems, which can undermine capacity building at both levels (Smoke 2007).

Recently, there have been more efforts from the donors to channel funds through budget support (i.e. the donors put their funds through the government budgetary system, sometimes with attached rules) and to reduce the number of parallel project management units. However, there is still a lot more to do for donors to move towards better integration and alignment with the government (Smoke & Winters 2011).

## **2.2. Design, Politics and Sequencing**

Core to the success of fiscal decentralisation is soundness of design, sequencing and dealing with its politics. First of all, fiscal decentralisation needs to be designed as a comprehensive system and all the pieces in this system must fit together. That means one needs to think not only about transfer of financial authority, but also about political autonomy, upward versus downward accountability and management systems (Bahl 1999; Bahl 2009).



Smoke, while emphasising comprehensiveness of reform design, pays more attention to the process by which these different pieces can be established. Politics and bureaucratic coordination and resistance are among the biggest challenges. That many central ministries need to be involved in fiscal decentralisation, that they all might have different views about decentralisation and that they might have reasons to resist the reform lead to tremendous challenges of coordination. Moreover, even in the absence of resistance, weak bureaucratic capacity will inevitably slow the process (Smoke 2007).

Romeo (2003), Rondinelli (2007) and Eaton *et al.* (2010) take coordination problems further, arguing that donor agencies and their projects contribute to this problem. Parallel donor projects and compartmentalisation within donor organisations of the expertise and responsibilities to support different reforms have led to fragmented and competing interventions that undermine policy coherence.

Political factors also loom large. They include motivations of the top politicians, relations between politicians and bureaucrats and competing interests among the Ministries of the Interior and Finance, line ministries and SNAs. Sub-national politics is also a concern, especially between councils and executive staff (Smoke 2007; Bahl 2009). Another often overlooked dimension is the role of political parties. Both the ruling and opposition parties have a stake in fiscal decentralisation. Depending on their political influence and capacity, they can have significant impact on the reform (Manor 1999).

Smoke and others argue that, while it is important to be comprehensive in getting all of the needed pieces of an intergovernmental system in place, it is equally important to take the same comprehensive approach (i.e., considering politics, bureaucratic capacity, donor roles) when designing and rolling out the reform. This indicates the significance of coordination.

Complementing coordination is sequencing. If a government attempts to do many things at the same time, it will likely overwhelm both central and local capacity. It is important to think strategically about which parts to move first (Smoke 2007). Sequencing involves different aspects. For instance, the steps in reform may start by putting legal and policy foundations in place, then moving to implementation and then monitoring and evaluation (Bahl 2009).

Other aspects of sequencing have more to do with when different components should be put in place. For instance, some argue that a SNA should first rely on national transfers and should move towards raising its own revenue only when local tax administration capacity has improved. Others see the timing and mixing of decentralisation and deconcentration as central to sequencing (GTZ 2009). Of course, when designing fiscal decentralisation, all these aspects are relevant.

To sum up, the literature reports that it is important to look at the components of fiscal decentralisation (functional assignment, revenue assignment and intergovernmental transfers) and at the process and design needed to build and strengthen these components. Comprehensiveness and coordination emerge strongly and ensuring them is a challenge, requiring strategic thinking and sequencing to bring different actors on board.

The following sections use the above literature as a guide to reflect on Cambodia.



## 3. Cambodian Decentralisation: Context and Progress

### 3.1. Reform

Cambodian decentralisation was initiated in a post-conflict situation in which five contextual factors are relevant:

- Political stability is a high priority in the country and in its decentralisation reform (RGC 2008c);
- As a result of war, Cambodia since 1979 has had insufficient time to build its national or sub-national bureaucracies. Functional assignment, and therefore clear accountability, has not been done properly even centrally; state revenues and budget allocations to social sectors, although rising, are still limited (RGC 2008c);
- Aid dependency is great. It was used to finance basic services and generated “learning by doing” (through the SEILA programme), which led to the first commune election in 2002 (Rudengren & Öjendal 2002). However, donors’ excessive use of parallel projects (e.g. hundreds of central project implementation units) has weakened the state and diluted pressure for reforms (Taliercio 2008);
- Conflicts have affected not only the government, but also the people. People in post-conflict situations tend to have little trust in and low expectations of the state (Oosterom 2009). This reflects the attitude of Cambodians (Malena & Chhim 2009) whose quiescence also reflects the elitist and hierarchical culture (Blunt & Turner 2005; Chandler 2008). Such popular characteristics are relevant for decentralisation, because the reform is not just about building state institutions, but also about promoting state-society relations and local participation;
- While economic growth in the last decade has reduced overall poverty, territorial disparities are still widespread. Economic opportunities, health and access to education, infrastructure and micro-finance vary between provinces and between urban and rural areas. Urbanisation and domestic migration are emerging trends (UNCDF 2010). Such variation requires a balance between nationally uniform and locally specific development policies.

In addition, a few specific factors are also relevant. First, as a response to governance problems, various reforms have been implemented—PFMRP, civil service, land, education, health, forestry, fisheries (RGC 2008c). These reforms have not been well coordinated with decentralisation. Second, while the literature says little on the role of political parties in reform,<sup>3</sup> they cannot be ignored in Cambodia. Since 1998, the Cambodian People’s Party (CPP) has become very dominant and is now pretty much alone in the driver’s seat. The party has its own political platform for decentralisation (Cambodian People’s Party 2008). Moreover, in the last 15 years, it has been very active in mobilising funds for local infrastructure projects (Pak forthcoming), something similar to what communes have been doing with their CSF. Third, the current fiscal decentralisation follows the fiscal reform adopted in 1993. After the formation of the 1993 coalition government, budgetary authority was centralised under the Ministry of Economy and Finance (RGC 1993; RGC 1994; RGC 1998). Centralisation was necessary at the early stage of reconstruction (IMF 2004). The 1993 reform, however has persisted and been used for rent-seeking and gate-keeping by the central budgetary authority (World

3 The exceptions include Manor (1999) and Eaton *et al.* (2010)

Bank & Asian Development Bank 2003; Pak & Craig 2008). This suggests that decentralising fiscal authority will inevitably run up against entrenched central interests.

### **3.2. Progress So Far**

This section discusses the progress of fiscal decentralisation, looking at its technical components and the process by which it has been taking place.

#### **3.2.1. Functional and Financial Transfers**

##### *Communes/Sangkats*

Local elections have brought more stability. Political rivals were elected to work in the same councils and joined hands to serve their local people (Rusten *et al.* 2004; Meerkerk *et al.* 2008). Elections have also built better understanding and trust between commune authorities and local people. Moreover, despite some problems with informal local fees,<sup>4</sup> in general, elite capture has not been a concern (EIC 2006; Meerkerk *et al.* 2008).

The commune/*sangkat* councils made possible a form of participatory development. With five to 11 members and one clerk hired by the Ministry of the Interior, the councils were given a broad mandate of representing the state and addressing local needs, ranging from security and public order and basic public services to social and economic development and the environment (RGC 2001). An unconditional grant, the CSF, was established and increased over time. In 2003, the CSF was set at 2 percent of state recurrent revenues. It was increased to 2.5 percent in 2004, 2.7 percent in 2008, 2.75 percent in 2009 and 2.8 percent in 2010 (STF 2008; RGC 2010d).

The current commune mandates and functions are too broad and vague. Many councils complain that they seem to be asked to deal with all the problems in their localities but are given only limited resources and authority (Pak 2010). Despite the increasing percentage, the CSF is still a very small amount: it grew from R43.8 billion in 2003 to R89.6 billion in 2007; the CSF in 2003 was only 0.24 percent of GDP, and in 2007 0.26 percent. In addition, while communes are required every year to present their development priorities in a district integration workshop, only one in three of those priority projects is funded (NCDD 2010b).

Aside from general administration, the CSF has been spent overwhelmingly on infrastructure projects: 65 percent on rural transport, 17 percent on irrigation, 6 percent on rural domestic water supplies (STF 2008: 97). This means that communes have been little involved in financing social services. More social support has come from line departments and NGOs (NCDD 2010b).

Despite unclear functions and limited resources, communes have been performing in relating to local development. Partly in response to local needs and partly at the initiative of councils (especially their chiefs), communes have been involved in social service delivery including security and social order, natural resource management, conflict resolution, waste and market management (especially in urban areas), education, health and agriculture (Pak 2010).

Performance of these social functions has been very uneven. Determinants besides commune chief leadership are external factors such as support from political parties and NGOs and cooperation

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4 However, informal fees are quite small. The estimated total informal fee paid to communes is USD5-6 million, equivalent to 10 percent of total annual unofficial fees paid by households to all public services, which were estimated to be around USD66 million in 2005 (EIC 2006).

from line ministry officials. Councils have been at pains to “do something” with their limited CSF. They have strongly urged the formalisation and clarification of their functions and the authority and resources that should accompany them (Pak 2010).

### *Provinces and Districts*

Before the indirect election in May 2009, only limited provincial and district reforms had been made.<sup>5</sup> Until then, the provinces were considered just an extension of the centre. The “provincial authority” had actually been the *salakhet* and the appointed governor, whose limited power and resources made them rather like a line department of the Ministry of the Interior. The *salasrok* (district administration), on the other hand, was not even considered a budgetary level (RGC 1998; Öjendal & Kim 2008).

According to the 1998 Law on Provincial and Municipal Budgets and Asset Management, *salakhet* has some broad expenditure responsibilities over buildings and equipment, staff salary, travel, public lighting, garbage collection, sanitation, health, gardens, parks and roads, water canals and the like. *Salakhet* also has some authority over tax and non-tax revenue, and additional subsidy transfers from the centre (RGC 1998).<sup>6</sup>

The revenues included tax on unused land, stamp tax and duty, patent and business licence tax, slaughterhouse tax, means of transportation tax, registration and purchase tax, street lighting tax, earmarked alcohol and tobacco taxes and hotel bed tax. Non-tax revenues could be derived from electricity supply, water supply and managing state assets (RGC 1998). These tax and non-tax provincial revenues were about 2.8 percent of general tax and non-tax revenue in 2002, and rose to 6.9 percent in 2008 (RGC 2002; 2007).

As part of the broader decentralisation reform, parallel funds were created to support provinces and districts, namely, the Provincial Investment Fund and District Initiative Fund. The PIF for 2009 was USD2.24 million, a large part of which funds provincial projects which serve the communes. The DIF in 2009 was USD780,000, covering 106 districts, each receiving USD30,000 for projects that reflect commune needs. Representatives of the communes are allowed to have a voice in the DIF allocation and spending (PSDD 2009).

The current provincial and district councils are entitled to their own funds (RGC 2008g: Article 44). However, because the Sub-National Finance Law is yet to be adopted, provincial and district budgets continue to be managed in accordance with the 1998 law, i.e. in the same way as prior to the 2009 election. Districts continue to receive their funds through provinces. A small difference is that district funds in the new system will be explicitly indicated in the budget of the provinces (Keat 2009).

Line departments are also key actors in provinces and districts. They have their own funds, but only to cover recurrent spending. They therefore have to request capital funding (to carry out development projects) from the Ministry of Economy and Finance (MEF) through their line ministries

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5 In 1994 provincial and district budgetary powers were centralised, a main concern being the centre losing control over some governors who used their power to engage in rent-seeking and natural resource exploitation (Pak forthcoming).

6 It is useful to note that provincial tax collection was more like tax sharing, as part of the tax was shared with the centre.

(Pak & Craig 2008). Some of these line departments have received more (deconcentrated) authority from their ministries than others. Education and health are the most deconcentrated, agriculture is somewhere in the middle, and public works is the least deconcentrated (Pak & Craig 2008).

Overall, decentralisation has been limited in rearranging intergovernmental fiscal relations. In 2007, about 78 percent of the overall budget was still under central control, about 20 percent under provincial control and about 2 percent under communes (Boex 2009). In the national budget laws for 2008, 2009 and 2010, a similar pattern is visible: allocations to provinces, communes and line departments together account for only about 20 percent of the total national spending (Table 1).

Table 1: Budget Allocations across Tiers of Government (million riels)

	<b>2008</b>	<b>2009</b>	<b>2010</b>
(1) Total national spending	5,573,383	7,259,566	8,299,773
(2) Provincial spending	206,776	356,950	326,370
(3) CSF from national budget	91,000	107,000	142,424
(2+3)/(1)	<b>5.34%</b>	<b>6.39%</b>	<b>5.65%</b>
(4) Provincial line dept funds	857,645	1,059,122	1,209,431
((2) + (3) + (4))/ (1)	<b>20.73%</b>	<b>20.98%</b>	<b>20.22%</b>

Sources: Annual budget laws for 2008, 2009, and 2010

In provinces, the main agency overseeing and coordinating the different funds (including the CSF) is the Provincial Rural Development Committee and its executive committee. Established in late 2002 under SEILA, this committee was placed under the management of the National Committee for Democratic Development (NCDD) in late 2008 (NCDD 2008). A separate financial management system was set up for these funds (STF 2008). Although approved by the MEF, this system is different from the state's mainstream budgetary management (Pak & Craig 2008).

### **3.2.2. Decentralisation and Local Services: Fragmentation Problems**

In Cambodia, decentralisation is central to local service delivery. However, given the limited fiscal decentralisation, the central agencies have more resources and responsibility in this respect. These different actors have not been well coordinated. This has led to three different levels of fragmentation, namely, (i) at policy level, (ii) at implementation level, and (iii) at reform level.

At the policy level, there has been no coherent policy for local development in Cambodia (UNCDF 2010). In a way, decentralisation is considered as a local development policy in which SNAs are thought to be important (RGC 2005). But various sectors also have development policies that relate directly to local development: education, health, agriculture and water (MOEYS 2005a; MAFF and MOWRAM 2007; MoH 2008). These different policies do not well reflect one another. Each policy tends to see service delivery through its own sectoral view and not in terms of how it relates to other policies or sectors.

These policies do not distinguish between urban and rural areas in terms of development and need for services, although such distinctions are obvious on the ground. A recent qualitative study suggests that in rural communes, the most urgent needs tend to be irrigation water for farming, roads, primary education and basic health. In urban *sangkats*, the problems of floods, bad sewage systems, water and electricity supply and waste management are overwhelming (Pak 2010).

A recent UNCDF report (2010) takes the urban-rural differentiation further, arguing that the current classification method might not reflect reality. While a number of censuses have been done and their quality has improved, the current classification between rural and urban is still based on weakly organised disaggregated data and inconsistent methodologies. The formal definition of rural versus urban is also quite different from the one used internationally.

Applying the OECD definition, UNCDF (2010) found that 48 percent of the Cambodian population can be classified as living in predominantly urban regions, compared to only 10 percent as commonly understood in Cambodia. While the appropriateness of both methods requires more scrutiny, such a big difference means that the current methodology in Cambodia needs a check.

At the implementation level, these policies are translated into activities through different management systems. The CSF, PIF, DIF and several other donor projects coordinated through the NCDD's annual work plan and budget have been implemented through a separate public expenditure management system (STF 2008). This system, while approved by the MEF, is different and separate from the mainstream budgetary system. For instance, except for the CSF, the funds for donor projects are channelled, not through the Treasury, but the commercial banking system (PSDD 2009).

Sectoral line agencies use a different system to handle their funds and deliver their services. Line departments have been spending their recurrent funding in accordance with the mainstream budgetary process. This system follows the 2008 Public Finance Law and its regulations. It emphasises compliance and gives a lot of power to the MEF, Treasury and their provincial departments. A provincial governor, who is a delegated spending authoriser, has limited power over the allocation and spending of line department funds (Pak & Craig 2008; RGC 2008f).

Cambodia has a dual budgeting system; its recurrent budget is managed differently from the capital/development budget (RGC 2008f). The capital/development budget is presented in the Public Investment Programme (PIP), which is a collection of hundreds of separate projects. The 2010–12 PIP has 536 projects (RGC 2009), largely funded by foreign aid. In 2010, donor funding accounted for 77 percent of the total USD760 million in capital spending.

The share of foreign aid in the financing of development projects brings local development close to the question of aid management. Donors support both decentralisation and sectoral service delivery. For decentralisation, some focus on service delivery, some on people's voice and demand for accountability. While these focuses are complementary, poor coordination among donors has resulted in different parallel programmes and policies and thus created fragmentation.

Donor-funded projects tend to take a more sector-focused perspective rather than decentralisation approaches to service delivery, e.g. favouring efficiency arguments and/or sectoral deconcentration rather than focusing on elected councils (Pak & Craig 2008). The main reason is the lack of harmonisation among donors or even among departments within the same donor agencies.

The main reason for fragmentation is the significant use of parallel structures for aid delivery. As of 2007, it was found that only 12 percent of aid was channelled through the formal public financial system (compared to 10 percent in 2005), and the formal procurement system was used for only 16 percent of aid (compared to 6 percent in 2005). While some progress has been made, another persistent feature of parallel structures is project implementation units: in 2007 there were 121, and it is unlikely that this number has been reduced substantially since then (RGC 2008b; VBNK & RBMG 2010; RGC 2010b).



At the reform level, decentralisation (which is seen as a Ministry of the Interior reform) and the PFMRP (which is the MEF's reform) have not been coordinated. The PFMRP has given little attention to how it should embrace fiscal decentralisation. As of late 2009, the PFMRP has Activity 27 devoted to fiscal decentralisation, but that activity is still broad, awaiting more details (RGC 2008d). It had not thought through what changes were needed in tax, non-tax, the budgetary process, procurement, treasury operation and oversight or transfer of functions and resources to SNAs.<sup>7</sup>

## 4. Next Steps

### 4.1. Long-Term Policy Directions

Although decentralisation since 2002 has focused mainly on communes, the government had long realised the need to reform provincial and district administrations. In 2005, it adopted the Strategic Framework for Decentralisation and Deconcentration, which envisioned a unified administration between the two levels (RGC 2005). In 2008, the Organic Law was passed, laying out the legal foundation for the indirect election of provincial and district councils in 2009.

According to the Organic Law, these councils have the authority to make legislative and executive decisions (Article 30). They manage affairs relating to new functions, duties and resources (Articles 42 and 43). The law also calls for the appointment (not election) of a Board of Governors headed by the governor, whose job is to implement the decisions and budgets approved by the councils (Chapter 3, Section 5).

In May 2010, after more than a year of preparation and many rounds of discussion, the NP-SNDD was adopted by the Council of Ministers. It has five programme areas: (1) organisational and institutional development, especially in SNAs, (2) human resource development, (3) functional assignment, (4) budget, financial and asset management and (5) institutional strengthening (RGC 2010c). Although programme areas (3) and (4) appear to be the most relevant to fiscal decentralisation, all five areas are closely related to the fiscal component of the reform (RGC 2010a).

These policy and legal documents provide some specific reform directions, including: (1) the reform is not just about creating a fund for provincial and district administrations, but will involve transferring functions and resources from line ministries (Organic Law, Chapter 5, Section 2); (2) downward accountability and especially the political authority of the communes shall be maintained (Organic Law, Article 98); and (3) within a unitary state, the SNAs will eventually become autonomous in their functions and funding (Organic Law, Chapter 5, Section 6). These are bold visions, given the very centralised and hierarchical nature of the current state.

The policy directions were also realistic about the challenges the reform will face, especially in coordination and sequencing. Regarding a unified administration, for instance, the policies emphasise the need for a Technical Facilitation Committee whose job will be to coordinate between councils and line agencies. They also expect a more phased movement starting from deconcentration and gradually adopting decentralisation (RGC 2010a).

Foreseeing these challenges, the NCDD was established in late 2008 with a mandate to coordinate and lead the reform. It has 16 members and is chaired by the minister of the Interior, with

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7 MEF D&D Working Group meeting (9 January 2009); Dialogue on local finance and budget in support of NP-SNDD, 13 January 2009

the ministers of Economy and Finance and the Council of Ministers as deputies. Other members include ministers or secretaries of state from other line ministries. The NCDD has three main subcommittees: functions and resources, financial and fiscal affairs and personnel administration (RGC 2008e).

In other ministries, it was expected that a working group on D&D would be established or activated. For instance, at the MEF, the working group was expected to include members from other departments, not just from the Department of Local Finance. Part of this group's job was to lead the finalisation of the SNA Finance Law and to improve Activity 27 of the PFMRP to make it connect better with D&D. Similar working groups were also expected of line ministries to facilitate their sectoral functional reviews and transfers.<sup>8</sup>

#### 4.2. Expected Roles of Different Tiers

The NCDD in early 2010 adopted the Outline of the Three-Year Operational Plan,<sup>9</sup> providing some concrete actions for 2011–13. First, it classifies current SNAs into regional and local, as indicated in Table 2.

Table 2: SNA System Types and Components

System types	System components	Number
Regional	Provinces	23
Local (metropolitan, urban and mixed)	Capital/khan/ <i>sangkat</i>	1
	Municipality/ <i>sangkat</i>	26
	District/commune/ <i>sangkat</i>	159

Source: NCDD 2010a: 4

The Outline of the Three-Year Plan is explicit about the expected roles of each tier of SNA. It states that the intention is gradually to transfer the bulk of service delivery responsibilities to the local administration, while strengthening regional (provincial) capacity in planning and strategic investment, as well as providing support to local levels. The district, it envisioned, will be the entry point for further discussion about functional assignment and service delivery (NCDD 2010a).

Two important points relate to this expectation. First, the district is favoured because of its economies of scale. Boex (2009) suggests that, for a developing country like Cambodia, the minimum efficient scale for public service delivery is from 100,000 to 200,000 residents. The average population size per commune in Cambodia is 8000, and per district about 71,000.

The district is a good point of entry also because of the limited presence of vertical line offices. Currently, vertical line departments are mainly provincial and only unevenly present in districts. This limitation is viewed as an opportunity because it allows the new district administrations to be established and new functions assigned from a comparatively clean slate (NCDD 2010a).

However, the opportunity can also be seen as a challenge, because a lot of work needs to be poured into building district administrations. Among other things, financial management, procurement and treasury systems need to be built. While these appear rather technical, making it happen is also political, calling for coordination, especially with the MEF and its PFMRP.

8 Dialogue on local finance and budget in support of NP-SNDD, 13 January 2009

9 When the more detailed Three-Year Implementation Plan (2011–13) was made available to me, this paper was already finalised and ready for peer review and editing. For the purpose of this paper, however, the outline (adopted in March 2010) is sufficient to give an overview of where the next reform is heading. Therefore, I will rely more on the outline than on the plan itself.

While district roles are preferable on efficiency grounds, their relations with communes are equally important. On this point, the Organic Law distinguishes between urban and rural areas. *Sangkats* are explicitly placed under the management of a municipality, which then delegates functions and responsibilities to them to ensure local development and democracy (Articles 111 and 112). The *sangkat* is not to have its own funds, but to depend on the municipal budget (Article 244). This arrangement is thought to be appropriate for urban development, which tends to encompass more than one *sangkat* and thus requires coordination from a higher tier (NCDD 2010a).

In rural areas, the law is explicit that a district needs to be accountable to the communes within its jurisdiction (Article 98). This arrangement seeks to balance between the political authority of commune councils and economic efficiency, which favours the district. This opens the way for cooperation between the two tiers: the district can help develop and implement the development priorities identified by the communes, which in turn are allowed to voice their interests and concerns in district policy formulation and resource allocation (NCDD 2010a).

## 5. Next Steps and Challenges

### 5.1. Functional Review and Assignment

The Organic Law requires that in the next step provinces, districts and communes be given, not just general mandates, but specific sectoral functions currently under the responsibility of central ministries (Chapter 5, Section 2). The Outline of the Three-Year Plan expects that the district is the best location for combining general mandate and sectoral functions (NCDD 2010a).

While this expectation has solid economic justifications, in the next step it is important not to lose sight of meaningful mechanisms to ensure that commune/*sangkat* voices are heard. Currently, only a broad “mutual consultation” is used to show the downward accountability of the district. Moreover, accountability should apply not only to planning and resource allocation but also to monitoring and oversight.

To give specific functions to the local level means taking some from central agencies. Until the adoption of the Organic Law in 2008, line agencies’ involvement in D&D had been very limited. During the formulation of the NP-SNDD in 2008–09, line ministries were asked to come up with preliminary lists of functions they might decentralise or deconcentrate in the next five to 10 years. From observing the events, I came up with the impressions below.

Each sector is different when it comes to decentralisation. Education and health, for instance, had been giving specific tasks to their provincial, district and service delivery vehicles (e.g. schools and health centres). The two sectors also seemed to be more receptive to the idea of functional transfers, through both decentralisation and deconcentration. Other sectors, such as agriculture, public works and irrigation, operated in a much more centralised framework. These sectors tended to be more cautious about decentralisation, and suggested only a few minor functions for deconcentration (RGC 2010a: Annex 1).

Sectors also differ in technical complexity of their services. Health service is more complicated than education. Technical complexity was one reason raised by line agency officials to explain why they would only deconcentrate but were reluctant to decentralise. Part of the reluctance came from a common perception that when, for example, vaccination is transferred to a commune, the commune chief or councillor will do the actual vaccination.



But functional transfers do not always mean that SNAs actually produce or perform the services. This misunderstanding suggests that in the next step, promoting understanding about the linkages between decentralisation and specific sectors is very necessary.

Functional assignment needs a common underlying concept of what constitutes a function, its components and the principles that inform its assignment to different tiers. Functional review and assignment should deal with these basic questions to avoid unnecessary disagreements, which might compound problems of coordination among ministries. Some attempts have been made to come up with a simple framework for functional review, unbundling an assignment (Flam 2008). Once that is done, it is important that it be adopted by the government and well disseminated to ministries and agencies.

#### Box 1: Preliminary Steps towards Functional Assignment in Education

Education is probably the most advanced sector in sectoral deconcentration. Since 2000, it has channelled part of its funds right down to schools (World Bank 2005). The current Education Strategic Plan takes decentralisation as a key component of its policy: "...on-going policy priority is to enable greater delegation of authority and responsibilities to provincial, district, commune and school level... A priority for ESP 2006–10 is to consolidate and extend measures that build up capacity for decentralised education service management at province, district and school level." (MOEYS 2005a: 15).

During the workshops conducted as part of the NP-SNDD formulation, Education was receptive to deconcentrating and decentralising specific functions. The D&D team of the ministry was considering 11 activities and responsibilities, six of which were approved as functions to be transferred during the next 10 years.

Those functions were (1) monitoring of non-technical work from kindergarten to secondary education, (2) provision of early childhood education and community kindergarten, (3) provision of informal education, including literacy and vocational training, (4) provision of primary education, (5) ensuring that there are materials, equipment and furniture in schools and (6) provision of education in areas beyond the national curriculum, such as music, art and sport.<sup>10</sup>

The identification of functions was like a warming up process, trying to get involvement from line ministries. A more serious consideration was needed about the rationale for these functions being transferred, and to which level, whether they should be deconcentrated first and then decentralised, the unbundling of each function into its components and which levels should be responsible for which components. Answering these questions requires both knowledge about decentralisation and specific detailed technical knowledge about the delivery of education.

More complicated are the financing arrangements that should accompany each function. Currently 12 Education programmes are funded recurrently. Capital spending is intended only for facility development and institutional and capacity development (MOEYS 2005b; Pak 2009a). Functional assignment first requires identification of functions and their costs. Costing can be challenging given the current lack of budget information.

A recent report found that budget information in the sector is fragmented into at least three parts: nationally funded recurrent spending, nationally funded capital spending and donor and NGO assistance. The ministry keeps only the first information; the second is available in an aggregate format from the MEF; the third type is kept on project-based. Despite efforts to bring this information together (especially on donor and NGO assistance), even ministry officials find it difficult to put a dollar amount on specific activities<sup>11</sup> (Pak 2009a).

10 NP-SNDD formulation workshop, 11 December 2008

11 Similar challenges about budget information were also identified in health (Pak 2009).

The concept of a function is currently not well developed in Cambodia. It is not well developed even at the centre, let alone at sub-national levels. Sectors such as education and health, which had gone through early decentralisation, have developed so-called programme activities and sub-activities. These activities, while they look like functions, are arguably more like breakdowns of tasks, mainly for budgeting and costing purposes (Pak 2009a; Pak 2009b).

Other sectors such as agriculture, public works and irrigation have a much less detailed list of roles and functions. Their responsibilities tend to be described with overly broad terms such as “establishing”, “coordinating”, “assisting” and “ensuring”. To capture what they really do requires a more detailed sectoral analysis and on-site study.

Connecting sectoral knowledge with decentralisation is crucial for the next step. Whether it occurs will depend very much on the efficiency of the subcommittees of the NCDD and the D&D working groups in line ministries. So far, some of those working groups have been active, others not. Technical support and capacity building about D&D will be needed to enable working groups to carry on their expected tasks.

Functional transfer is a long-term process, expected to continue beyond the life of the current NP-SNDD (which ends in 2019). The process is made even lengthier by Cambodia’s highly centralised public administration. Not only have regional and local administrations been given limited authority and resources, but even sectoral deconcentration has been limited (Pak & Craig 2008). This means that functional transfers to councils and sectoral deconcentration and delegation need to happen in parallel (NCDD 2010a).

Whether through decentralising or deconcentrating, the SNAs receiving new functions need capacity building. Where a function is decentralised, the need is obvious because the SNAs themselves will be accountable for the functions. But even where a function is deconcentrated or delegated, SNAs need to improve their capacities, especially in development planning, integration of planning and budgeting of vertical line agencies, horizontal coordination and oversight.

The Outline of the Three-Year Plan offers an option for the short-term implementation of functional transfer. It expects that the process will start with the piloting and country-wide replication of provincial deconcentration arrangements and district contractual delegation. For the contractual arrangement, the districts would act as autonomous bodies executing national ministries’ and agencies’ programmes (NCDD 2010a). The arrangements are expected to vary from one sector to another, as will the sharing of responsibility for planning, programmes, implementation, monitoring and oversight.

## **5.2. Own Source Revenue and National Transfers**

“Finance follows functions’ ” is what international practice and the Organic Law emphasise (Article 217). The current vertical imbalance is significant. Despite that, the government, through the Organic Law and policy documents, is clear that SNAs will be given more resources for both general mandate and specific sectoral functions (NCDD 2010a). SNAs can appropriate financial resources from their own source revenue (Article 246) and conditional and unconditional transfers from the central government (Articles 247–249).

An appropriate framework for discussing SNA financing has three components: (1) what functions should be financed by what kind of sources, (2) how that financing is transferred in a predictable and transparent way and (3) how the transferred funds are used accountably (NCDD 2010a). The current policy is still at an early stage, providing only a road map of how these components

will be established. However, some specific policies offered by the Outline of the Three-Year Plan are summarised in Table 3.

Table 3: Functions and Corresponding Financing

Types of functions and responsibilities	Corresponding types of financing
<b>General mandate functions (permissive)</b>	Own source revenue (tax and non-tax)
<b>General administration</b>	Unconditional transfers
Specific functions delegated	Contractual financing from delegating agencies
Specific functions assigned (obligatory)	Conditional transfers
Capital development programme associated with any of the above (e.g. investment in infrastructure)	Project financing facilities

Source: (NCDD 2010a: 9)

SNAs in due course will be given authority to collect their own source revenues, both tax and non-tax. First, decisions need to be made about which tiers should be given which revenues. Shared revenue among tiers is also an option. Second, to promote financial autonomy and downward accountability, SNAs will gradually be empowered to exercise discretion in setting the bases and rates of their assigned revenues under conditions and arrangements to be determined (NCDD 2010a).

SNA discretion over revenue rates was raised during the NP-SNDD formulation. One of the possible scenarios was to allow SNAs to set the rates within a limit set by a national law. That scenario was understood as a feasible option.<sup>12</sup> However, one should be realistic as to when such a scheme can be introduced. A high official in the Tax Department, referring to the currently weak tax administration and the lack of taxpaying culture among Cambodians, argued that such a scheme, while conceptually sound, might take five to 10 more years before it could become practical. This is just one opinion, but a legitimate one.<sup>13</sup>

The shortcomings of the administrative system for non-tax revenue collection might also slow the reform. An interview with the Non-Tax Department of the MEF indicated that some major non-tax revenues are under revenue-generating ministries and agencies, including Agriculture and Mines and Industries. Coordination between these line agencies and the department has not been smooth. This suggests that, once the discussion about non-tax revenue assignment proceeds, not only the MEF, but also relevant line ministries need to be involved. This highlights the need for and challenge of coordination.

However, the reform of revenue transfer for SNAs does not start from nothing. Provinces since 1998 have had authority to collect various tax and non-tax revenues (Bartholomew & Betley 2004). This existing practice can be used as reference and learned from. However, in districts, to which more functions are expected to be transferred, there is no similar practice (Öjendal & Kim 2008).

While own source revenue assignment is important, it can reasonably be expected that, in the short and medium term, SNAs will have to rely mostly on national transfers. For communes, a lot has been learned from the CSF (Dom 2008). For provinces, while the current transfer system can serve as a point of comparison and learning, it is still limited in the sense that it has not been formula-based, and thus proved to be regionally inequitable (Boex 2009).

More work is needed in districts before they can receive national transfers. With no district budgetary system already existing, a completely new one has to be developed. When the Outline of the Three-Year Plan was adopted, three possible mechanisms were proposed for the financing of general mandate district functions. The first is to create a District/Municipal Fund, similar to the

12 Dialogue on local finance and budget in support of NP-SNDD, 13 January 2009

13 Interview with Tax Department official, 21 January 2009

CSF, capitalised with 0.5 to 1 percent of state domestic revenues and distributed by a transparent formula.

Box 2: Linking Decentralisation to Service Delivery: Agriculture and Water Resource Management

Budgetary allocation between the centre and SNAs is much less decentralised for agriculture and water resources than for education (RGC 2008a). In both of the former sectors, as the Strategy for Agriculture and Water (2006–10) (MAFF & MOWRAM 2007) indicates, policy focuses are enhancement of agriculture and rehabilitation and construction of physical infrastructure. It has eight components, two of which serve here as illustrations:

- Component 7 (increase productivity of agriculture)
- Component 5 (empower people and communities).

Recently, a public expenditure review on agriculture and water found that in both sectors, functional analysis was impossible because the current budgetary classification is done according to administrative units (ministries and departments) and economic functions (recurrent or capital). Instead, the review used department recurrent budgets as a basis for its spending analysis of functions (World Bank forthcoming).

The public expenditure review found that, in agriculture, while agricultural extension service was said to be important for improving agricultural productivity, it received only about 2.8 percent (about 1,212 million riels) of total ministerial recurrent funds in 2008. Interestingly, though, agricultural extension has received a lot of donor support: about 95 percent of total funding for 2008 (about 24,389 million riels) (World Bank forthcoming).

This funding pattern is particularly relevant to functional transfer within D&D. During NP-SNDD formulation, the Ministry of Agriculture proposed 10 functions (actually more like responsibilities) to be transferred. One that it proposed to transfer immediately to districts was to “ensure provision of agricultural extension services on rice, vegetable cultivation and livestock farming to farmers”.<sup>14</sup> With the funding share presented earlier, one can reasonably expect that, if the function is transferred, it will affect donor projects more than the ministry’s budget.

This illustrates that decentralisation can have strong implications for donors’ practices. Some donors have already started to think seriously about this. The ADB conducted a review of some of its agricultural and livelihood projects, one of which is the USD55 million Tonle Sap Poverty Reduction and Smallholder Development Project. It concluded that the centralised project implementation unit approach tends to incur high overhead costs, and that the district might be a good choice for actual service delivery (Niazi & Lamont forthcoming).

The water sector provides another interesting story. Unlike agricultural extension, which is a service, the water sector provides infrastructure and therefore has a lot more capital expenditure. But the current budgetary classification does not allow proper functional analysis. The best way was to use departmental budget as a basis, as the public expenditure review did (World Bank forthcoming).

In the Ministry of Water Resource Management, the Engineering Department is responsible for irrigation operations and maintenance. The budget for this was very small compared to the total departmental budget: less than 10 percent in 2006–08 and only 14 percent in 2009. This amounted to less than USD1 million for the whole country. The serious lack of funds for operation and maintenance of irrigation schemes led to lack of sustainability (World Bank forthcoming).

During NP-SNDD formulation, the ministry proposed only two functions for transfer: repair and maintenance of small-scale irrigation, to be transferred to districts in five years; and facilitation and support for farmer water user groups.<sup>15</sup> Even if the two functions are transferred, it will not make much difference unless funding for operations and maintenance is increased.

The Agriculture and Water Policy emphasises the empowerment of community-based organisations such as farmer water user groups and other self-help groups (Component 5). At least in agriculture, these non-state actors have been playing important roles in local development. While their effectiveness is still debatable, state support to and collaboration with these groups has been limited (Ngin 2010; World Bank 2010).

To make such groups effective and sustainable, support from the government and well-defined roles and responsibilities are important (Ngin 2010; So *et al.* 2010). Therefore, when considering decentralisation, it is important to think of appropriate links and cooperation between deconcentrated SNAs and community organisations and self-help groups.

14 NP-SNDD formulation workshop, 11 December 2008

15 *ibid*

The second option, called CSF bottom-up transfers, is to increase the current CSF from 2.8 to 3.5 percent of domestic income through 2011–13, stabilise the share of resources for the CSF and transfer the balance to districts and municipalities.

The third is to set aside an allocation from the state budget for the districts and municipalities (NCDD 2010a). This resembles the current salakhet budget (for the salakhet budget, see Bartholomew & Betley 2004; World Bank 2005; Pak & Craig 2008).

When the more detailed Three-Year Implementation Plan was adopted in November 2010, the first option, i.e. a District/Municipal Fund (DMF), was chosen (NCDD 2010c). This decision gives districts their own funds, as stipulated in the Organic Law (Article 44). This means they will have the ability and discretion to allocate resources to locally identified needs, in accordance with the legal and regulatory framework.

Financial autonomy directly affects the kind of financial management systems to be set up in SNAs. At this early stage, there seems to be conflict between the Organic Law, which envisions a more decentralised system, and the 2008 Public Finance Law, which emphasises a more centralist approach. The latter provides that the central government approves SNA budgets, thus giving the MEF authority over SNA budget negotiation, and that SNA budgets need to be approved by the National Assembly (RGC 2008f: Chapters 3 and 4).

The Public Finance Law foresees significant roles played by the Treasury and its provincial and district branches. They include processing and managing payments, accounting and financial reporting. At the time of NP-SNDD formulation, the Treasury had planned activities to support decentralisation, including preparation of a new chart of accounts for districts and municipalities, fund transfer mechanisms and other related logistics and personnel.<sup>16</sup>

While appearing to emphasise a central presence, the roles and activities of the Treasury should be seen as supporting and safeguarding public funds of the SNAs. It is not a question of either SNA or central, but of finding the right balance between SNA autonomy and accountable use of public funds. These matters will be addressed in the upcoming Sub-National Finance Law (Keat 2009).

### **5.3. Donors' Roles and Development Projects**

Donors have started to consider how their financial aid, technical advice and aid modalities should adapt to the new policy direction of the NP-SNDD. About 15 donor agencies have formally and informally planned what they can do to support the reform. They form four different sub-groups, each focusing on a different aspect (Niazi & Lamont forthcoming).

- The European group emphasises democracy, accountability and citizen voices within the reform.
- The UNDP group focuses on broad policy and has been quite influential, working closely with the NCDD.
- The World Bank, ADB, UNCDF, GTZ and UNICEF are interested in fiscal aspects of decentralisation.

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16 Interview with National Treasury officials, 5 December 2008



- Other donors including JICA, Danida and AusAid, operate on a project-based approach, with some links to broader decentralisation policy.

The World Bank, ADB and UNCDF play a key role in fiscal decentralisation, agreeing among themselves to work more closely, though their work plans and activities still need further coordination. UNCDF has been supporting the drafting of the Sub-National Budget Law, while GTZ and UNICEF have started conceptual work on functional assignment (Niazi & Lamont forthcoming). The role of the World Bank and ADB is particularly important, for both have also been helping with the PFMRP and thus are in a good position to coordinate the two reforms.

The more challenging point about the donors is how their project-based modalities will affect components of the reform. It is important that donors adjust their ways of doing things. The ADB, for instance, analysed its indicative pipeline projects for 2009–12. Those projects were coded as to whether they would be under the aegis of the central government, SNAs, regional projects or the central government and SNAs jointly. Principles such as subsidiarity, efficiency, equity and economies of scale guided the coding and determined which level should be responsible for which functions. The analysis found that, if the regional projects were not considered, about 23 percent of all the functions would be under the central government, and the rest would be the shared responsibility of the centre and SNAs. The ADB thus has to decide on which projects and activities it should continue to work with ministries and on which it should start to work directly with SNAs, especially districts (Niazi & Lamont forthcoming).

A real challenge of donor involvement comes from project versus programme-based approaches. Projects are by nature for a specific period, and their sustainability tends to be in question. This is different from a function, which emphasises sustainability and accountability by tiers of government. It will be a challenge to bridge project-based and functional classification, requiring careful sequencing and well-coordinated processes.

Taking into account the current progress with PFMRP, donors in the foreseeable future still have legitimate reasons to continue using parallel structures and not the government financial management system. This partly explains why, in the Three-Year Plan of the NCDD, the project financing facility is expected for capital development programmes associated with permissive, delegated or assigned functions (Table 3).

## **6. Conclusions**

By way of conclusion, key points and arguments are re-emphasised.

First, to achieve democratic development, fiscal decentralisation in the next step needs to be seen as both institutional and service delivery reform for local development. This implies that the reform needs both to put in place key components and to link more closely and explicitly with service delivery. The decentralisation-sectoral reform link has been limited in the past; for the next step, this limitation needs to be overcome.

Second, the next step needs to be comprehensive, not just in the sense that all components are brought together as a system, but also in terms of the process by which such components are established. Comprehensive process entails shifting gradually from fragmented approaches to more coordinated ones. Coordination needs to happen at different levels: policy, implementation and reform.

Third, being comprehensive should not be taken to mean that everything is done at the same time. That would overwhelm existing capacity and go against the more gradual, learning by doing philosophy of Cambodia's decentralisation. Being comprehensive means being able to set out the longer term vision, expecting the kinds of challenges that will be faced and planning realistic and flexible sequencing strategies.

Fourth, linking decentralisation to sectoral policy is particularly challenging—especially so given the current centralised, patronage-based process associated with sectoral service delivery and state budget management. The challenges are compounded by the parallel, fragmented nature of donor support through numerous vertical projects. Overcoming them requires that fiscal decentralisation in the future not be seen as mostly initiated and driven by the Ministry of the Interior but by the sectors themselves. That donors be involved and supportive of decentralisation is no less important.

Lastly, this paper argues that there are reasons for both optimism and pessimism about the next step of fiscal decentralisation expected under the Organic Law. On the one hand, successful experience with communes since 2002 gives a strong hope that the government will again prove its adaptive capacity to navigate the reform. On the other hand, commune reform has touched very little on the kinds of tasks expected in the next step. Some very basic components and tasks, including functional assignment and revenue assignment, were hardly implemented under the commune reform. Starting on these tasks will definitely run into resistance from central agencies, a test that will prove how committed government is to fiscal decentralisation.

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