

8. Institutions and equity in the development process

Summary

- Contemporary economics emphasizes the importance of institutions—both formal structures and the values and practices in which they are embedded—in explaining national development outcomes, including equity and equality outcomes. International experience suggests that state institutions that reflect the interests of the poor and promote equality of opportunity foster more stable politics and more sustainable long-term growth than those which concentrate power and wealth. Building such institutions is often hard in post-conflict states. In Cambodia, surveys identify informal fees as a critical burden on firms, and reveal corruption and lack of trust in state institutions as major problems.
- The state can foster equitable development in the way it raises and directs public finances. Cambodia's public financial management (PFM) system has many serious problems; however, progress in PFM reform has opened up possibilities for more effectively and efficiently directing public spending towards poverty reduction. Priorities include putting in place strong, transparent measures for using revenue that is expected to flow from oil and gas within a few years; reallocating spending towards priority goals; raising capital spending, emphasizing economic sectors (roads, irrigation, energy) that shape distribution of opportunities and the pattern of growth; and increasing recurrent spending on maintenance (to sustain the value of capital investments) and, critically, on public sector wages. Building RGC institutional capacity through increased civil service salaries and better management may be as important as investing in infrastructure.
- Besides spending, the state guides growth and poverty reduction by formulating and implementing rules that establish the conditions for interaction between economic and social actors. In pursuing equity objectives, liberal democracies rely heavily on the rule of law—that is, governing society with clear rules applied fairly to all. In Cambodia, state law is not yet established as the primary source of authority: often, it must compete for legitimacy and influence with other rule systems. Cambodia's legal and judicial systems are not currently very effective or supportive of equity: the law is often applied selectively to enforce decisions of dubious legitimacy or protect influential individuals from prosecution. Building the rule of law involves fundamental change in how society is ordered and power exercised. Incentives to reform may reflect international processes (e.g. trade negotiations) or political considerations (e.g. concern regarding popular mobilization around land issues). Legal and judicial reform strategies need to understand that the rule of law emerges as much from processes of social contest as it does from technical change.
- Progress in Cambodia has often been achieved in enclaves, aiming to develop robust institutions and later build outwards, rather than attempting to implement comprehensive institutional reform in one round. Thus, ties to trade quota agreements created incentives for improving working conditions in the garment industry; and principles of participatory and accountable local planning, introduced via donor-supported “project law” under the Seila program, have taken root and come to influence RGC thinking on decentralization and deconcentration policy. In both cases, outcomes fall short of the ideal envisaged under concepts such as the ‘rule of law’, but do mark a significant advance on what existed before, and may open up possibilities for future stepwise progress.

Institutions and development: state responsiveness, legitimacy and the policy process

Market institutions are embedded in and depend for their effectiveness upon a much broader set of social and political institutions. (Box 8.1 discusses what is meant by “institutions”.) A wide variety of organizational actors interact to shape economic and social relations, and help determine the degree of equality or inequality of opportunity that different individuals and groups face in participating in markets and obtaining access to services. These include the courts and police; the media; the executive and legislative bodies; the civil service; political parties; civil society organizations based on principles of collective action or charity; and private sector associations that seek to lobby policy-makers on the basis of collective business interest. The orientation and effectiveness of these bodies are in turn rooted in institutions (practices and norms), such as the constitution and laws; the rules (formal and informal) of the policy process; socially-defined gender roles; national, ethnic or regional identities; and values and expectations with regard to vertical (patron-client, class, administrative hierarchy) and horizontal (solidarity, cooperation) socio-economic relations and forms of social organization.

Institutional arrangements that are conducive to long-run economic growth and structural transformation tend to be those

Box 8.1 What do we mean by “institutions”?

The term “institution” is awkward, as it is used in English in at least two different ways. In academic terminology (e.g. in the New Institutional Economics literature), there is a commonly accepted distinction between institutions as the “rules of the game” and organisations as the “players”¹. In daily usage, however, the term institution is often used interchangeably with organisation, so that a Ministry of Health, an NGO, or an inter-Ministerial committee are also described as institutions. Bratton and de Walle explicitly accept that the term can be used in both senses:

political institutions can be highly abstract notions, such as constitutional principles, or they can be expressed concretely in actual organisations, such as trade unions, political parties, or the military. They include key aspects of formal politics, like the judiciary, but also informal customs such as patronage, clientalism, seniority principles, or lobbying¹.

Huntington links institutions and organisations in an interesting manner, defining institutions as “expected patterns of behaviour”, which helps to establish the distinction between organisations that are institutionalised (ie. predictable in their procedures) and those that are not. O’Donnell argues that consolidated democracy is institutionalised democracy--ie. political actors work on the assumption that democratic processes will continue to be the major means of managing conflict in society. He also draws a distinction between formal institutions (elections, parliaments, courts) and informal institutions (patron-client networks, influence of elders)¹. This helps to frame an analysis of the policy process, to the extent that regularised political frameworks are more accessible than discretionary and unpredictable ones.

Institutions and their organisational expressions help to provide a concrete focus for the examination of policy choices, in both the short and long term. By setting the rules of the game (and determining which actors can play) institutions both perpetuate and transform the nature of state-society relations.

which exert checks and balances and limit the natural tendency for economic and political power to reinforce each other. To put it another way, economies which succeed in achieving stable long-run growth tend to have institutions which put limits upon the growth of inequality in political voice and power. By contrast, when economic and political power are both concentrated in the hands of a small and unaccountable elite that lacks either the vision or capacity for state-directed development, the result is generally “bad” institutions which protect the property rights of in-group members but not others; are inconsistent in enforcing contracts; focus upon extracting rents rather than identifying new investment opportunities; and ration market entry and access to capital and information.

This is reflected in the World Development Report 2006, which argues that institutions tend to evolve in vicious or virtuous cycles. Less equitable social structures lead to the formation of institutions that perpetuate inequalities in power, status and wealth; conversely, equitable institutions only emerge in situations when the distribution of power is not highly unequal. In these terms, one dilemma of development is how to bump a society from the vicious cycle of self-reinforcing inequality to the virtuous cycle of self-reinforcing equity (World Bank 2005 pp. 8-9).

Inequality in the ways institutions treat different groups of citizens also matters for legitimacy and governability. If it is widely believed that wealth differences result from unfair rules, this undermines people’s faith in politicians and officials, making it harder for Government to retain people’s loyalty and ensure their compliance with law and policy (see Mekong Economics 2006 for a discussion of inequality and legitimacy in Vietnam). High inequality also undermines the trust required for citizens to work together to solve their own problems (Labonne et al 2006); and is clearly related to the incidence and severity of crime (Demobynes and Özler 2005). Internationally, there is a relationship observed between high levels of inequality and weak (unfair) institutions associated with these levels of inequality, on the one hand, and the increased likelihood of social and political instability, crime, and violence, on the other (Bourgignon 2004 citing Rodrik 1998). This is especially the case when the inequalities in question are horizontal or group-based inequality (e.g. between regions or ethnic groups: Killick 2002). Conflict also imposes opportunity costs, in the form of resources (public and private) diverted from more profitable activities into preventing and fighting crime. Beyond a certain threshold, all these act as deterrents to investment, lending and economic growth.

Post-conflict recovery and institutional evolution in Cambodia

That Cambodia demonstrates many of the kinds of institutional shortcomings described above (see Box 8.2) is unsurprising, given its legacy of conflict. At the collapse of the Khmer Rouge in 1979, all political institutions were destroyed. The People’s Republic of Kampuchea (PRK) thus had to rebuild the institutions of the state from the ground up, in the context of a civil war against foreign-backed insurgents; extreme shortage of material and human resources (amounting in the first years to economic collapse and incipient famine); geopolitically-inspired exclusion from international trade and investment (and most of the international aid system); and a weak foundation of popular legitimacy. In this context, it is unsurprising that the political

institutions that emerged after the Khmer Rouge prioritized the basic task of forming and protecting the state over more advanced aspirations to transparency, accountability or democracy (Hughes 2003; Gottesman 2003).

These institutions have evolved considerably since 1979 with the shift to market economics (beginning in 1989) and, in the Paris Peace Accords of 1991, the end of Cambodia's civil war and agreement on arrangements for the transition to multi-party democracy¹. The abrupt transition to market economics and insertion of Cambodia into regional and global economies enabled officials of the PRK (from 1989 to 1993 re-named the State of Cambodia or SOC) to establish an early privileged position in the marketplace, bringing political position and economic power together to a degree that had not been possible under the enforced slow-growth isolation of the 1980s.

Box 8.2 The quality of local governance is a major, generally negative influence upon opportunities, which will probably require national solutions

“The MOPS demonstrates that good governance is fundamental to development and poverty reduction. Growth, development and poverty reduction can still take place in the context of poor governance and weak institutional capacity, but are slowed, or even halted by corruption, impunity and weak rule of law. This point was made again and again in study villages; unpredictable, unreasonable, and crippling corruption costs are actively preventing many households from going about their daily business and earning a sustainable income.

“The RGC is committed to strengthening local government through the de-concentration and decentralization process. The MOPS suggests that strengthening the financial and administrative capacity of local institutions is important as there is more that local authorities can do, for example to manage local conflicts, involve community members in decision-making, reduce domestic violence and so on. But this will only be effective up to a point, as local authorities are effectively powerless to act once powerful, external influences are involved.

“Significant governance failures, in particular in relation to natural resource management, cannot be addressed at the local level and require a national response. Political will is required to implement government policies and impose consequences on those who break the law.”

Source: CDRI 2007b, forthcoming.

Acting as a partial countervailing centrifugal force to the power-centralizing effects of unregulated economic liberalization, the 1993 Constitution laid out a framework vision for a liberal democratic state. Over the last decade reform-minded actors in Government and civil society, together with the UN, donors and international NGOs, have sought to use this framework to create political space for the evolution of an independent civil society, free press, and the separation of powers. The RGC has made significant commitments to principles of equitable development, as seen in the Rectangular Strategy (RGC 2004), the NSDP 2006-2010 (RGC 2006), and the CMDGs (many of which relate explicitly to equity targets). Through allocation formula for the commune/sangkat fund and an ongoing process to develop a national methodology for low-cost identification of poor households, it is also now developing practical mechanisms to meet NSDP goals for better targeting poor areas and poor households.

¹ The Khmer Rouge subsequently reneged on this peace agreement and returned to armed opposition to the state. The last pockets of this opposition finally surrendered only in 1998.

Legal pluralism and governability

A striking feature of Cambodia is the prevalence of what may be described as *legal pluralism*: a situation in which several, often contradictory and competing, rules and norms influence social, economic and political relationships. This situation is not unique to Cambodia: many developing countries are characterized by the existence, in parallel, of traditional, religious, administrative, legal systems, each with different (and unreconciled) definitions of rights, duties and principles and institutions for mediating disputes (Moser *et al* 2001). Legal pluralism typically becomes less important at later stages of economic development: a well-resourced state, sustained by a broad tax base and kept in tune with popular concerns and mores through democratic elections and other channels of accountability, has a greater capacity to project a legitimate definition of law (and to define law in such a way that aligns popular and formal concepts of rules and norms).

Box 8.3 ‘Political will’ and challenge of institutional reform

Difficulty with governance and particularly and justice sector reform in Cambodia is regularly ascribed to a “lack of political will” (e.g. Global Witness 2005; US Embassy 2006; AHRC 2007). This concept is at once illuminating but also limiting. On the one hand it correctly identifies that reform of these key sectors is an inherently political process in that it involves a redefinition of how power is exercised within society. On the other hand, the concept of a lack of “will” is reductionist in that suggests that reform could occur through a simple change of sentiment. This underestimates the extent to which current arrangements are maintained by deeply interwoven and self-reinforcing systems of norms and incentives. The difficulty of achieving governance reform in a country like Cambodia is thus better described as a problem of systems and the powers that support them than a problem of will. The question in terms of how more equitable institution of governance could be developed is thus not so much about how will is created but how complex systems are transformed.

Low income developing countries, by contrast, often demonstrate a degree of legal pluralism, in which national laws are a significant but not exclusive reference point when actors negotiate rights and duties. Legal pluralism is particularly pronounced in countries, such as Cambodia, which have in a relatively short span of time been subject to a succession of legal frameworks (pre-colonial, colonial, socialist and liberal-democratic); and / or where the reach of state law has been weakened due to war, revolution and rapid re-insertion into regional and international markets and political-legal frameworks (e.g. the international human rights system built around the UN; WTO rules on trade and commercial law; and so on).

In Cambodia, constitutional and statute law often compete both with (i) social norms (e.g. a historically deep-rooted concept that vacant land can be cleared and occupied and that the act of farming confers land use rights) and (ii) neo-patrimonial administrative conventions, in which the formal distinction between public and private property is blurred, and underpaid Government officials assume the right to use their office to generate rent (e.g. from informal charges for services that are officially free) or to authorize transactions (including lease or sale) of state assets (e.g. land) that fall within their jurisdiction. In a situation of legal pluralism, parties will typically engage in “forum shopping”: that is, selecting the legal forum and underlying normative principles which

best legitimizes their claims. Unfortunately, the wealthy and educated are better positioned to shop for a forum supportive of their case, and to deploy the power of the state to back up their claims. Qualitative research clearly reveals a widespread perception of an imbalance in power, and the consequences of this in terms of inequality of opportunity (Box 8.4)

Box 8.4 “Rights in practice”: power confers greater opportunities for the rich

Cambodian society has traditionally been ordered in a hierarchical manner, even if relative status and power in any given relationship was a composite of many different factors. Asymmetry in rights and the pointlessness of resisting this inequality are reflected in many traditional Khmer proverbs, such as “The egg cannot fight the stone”. While recent qualitative research reveals increasing popular understanding of the *concept* of equality of rights that is the central principle of a liberal state, it also reveals widespread agreement that this situation has yet to be established in Cambodia, given that the rich and those with connections have more rights in practice.

The people are poor and ignorant. That is why they [the powerful] grab land and abuse rights. Even if the people know the law, but they are poor, there is still no justice in dispute resolution, because the others have power, money and they also know the law. Pagoda committee member, Prasat Sambo District, quoted in CAS and World Bank 2006 p. 31.

At that time the villagers did not complain because there was no way. They did not know to whom they should complain when the village chief refused to help. Informal leader, Prasat Sambo, quoted in CAS and World Bank 2006 p. 20.

I am poor: if a problem arises with a wealthy person I prefer to drop the issue so the matter will not go too high, because I know I will lose. I try to avoid problems with the rich; they have power. Woman, 50, Svay Rieng Province, quoted in Luco 2002 p. 98

Sources: CDRI 2007a, 2007b, CAS and World Bank 2006 p. 16.

This theme of legal pluralism, and the challenges *and* opportunities it creates for moving to equitable, pro-poor institutional formations, is addressed later in this chapter in the context of labor law and local governance reforms.

Promoting equity through public spending

Public financial management (PFM) is not the only tool by which Government shapes economic and social outcomes: the state also regulates economic and social activity through legal and regulatory functions, through monetary policy (setting interest rates and otherwise controlling inflation), and through influencing identities, values and ideology. Nonetheless, control over the level and allocation of public spending (and how it is financed) is typically the most important lever by which to influence outcomes, including equity, both directly and indirectly (see Box 8.5)². Correspondingly, while there are lenses other than PFM through which to examine a state’s effectiveness in achieving goals, analyzing patterns and trends in public financial management is the logical starting point.

² The role of state spending may be particularly influential when state revenues are large relative to the real domestic economy as a whole: this is clearly not the case in Cambodia at the moment, but this may well change in the near future once oil and gas revenues start to come onstream.

Box 8.5 Core concepts in public expenditure policy

In theory, any productive and efficient expenditure within an economy should, all things being equal, contribute to higher growth: in practice, however, the link between public (i.e. Government) expenditure and growth is a topic of debate. The two key issues of interest are (i) the level of total public spending and (ii) the composition of that spending, in terms of the balance between different sectors and categories of spending.

To assess whether the *level of spending* is appropriate requires comparing aggregate spending to the size of the economy and analyzing the sources from which this spending is financed. The spending-to-GDP ratio is important because high levels of public spending can fuel inflation, affect the value of domestic savings, and potentially crowd out private investment. The sources from which spending is financed (domestic tax and non-tax revenue, borrowing, and ODA) matters because the benefits of taxation-funded public expenditure may or may not exceed the costs (economic and political) of taxing, if high levels of taxation deter economic activity and impede the efficient operation of markets, resulting in a slower rate of economic growth for which tax-funded public spending only partially compensates. Spending financed by borrowing, meanwhile, stores up public debts which may come to undermine the sustainability of public finances and macroeconomic stability in the future.

The *composition of public spending*, meanwhile, needs to be guided by a different set of trade-offs. The first is between general types of sector (e.g. economic sectors vs. social sectors vs. general administration), sectors (e.g. health vs. education, or roads vs. irrigation) and sub-sectors (e.g. vertical disease control programs vs. primary health care systems). Here, the balance of spending needs to reflect analysis of the returns to different potential uses of limited public funds: for given economic and social objectives, is the Government better investing an additional dollar in healthcare, or in irrigation? The second set of trade-offs is with regard to the balance to be struck between capital (new investment) and recurrent (wage and other running cost) expenditure.

Public expenditure policy can be an important influence upon equity and efficiency within a given economy. As discussed earlier, there is a broad spectrum of policy options within which the goals of increasing efficiency and increasing equity are compatible and even on many grounds complementary. There are also, at the extreme ends of the spectrum, positions which may achieve short-term equality at the cost of suppressing markets and slowing growth; or which focus exclusively on maximizing short-term aggregate output, with no regard for the inequality of the distribution of that wealth. Neither of these polar positions is likely to be sustainable, or desirable, over the long term.

Gains in revenue collection would enable higher, pro-equity spending***Cambodia enjoys considerable potential to expand spending***

The fundamental problem with Cambodian public expenditure policy is that the level of public expenditure is extremely low, severely limiting the potential for using spending to influence economic or social development. Public spending as a percentage of GDP has ranged from 17.6 in 2002 to 14.4 in 2005, averaging 16.3 percent between 2002 and 2005. This is low by any standard, including comparison with other low income countries: from 1995-2004 Cambodia's total expenditure averaged 15.2 percent of GDP,

compared with the low income country average of 25.1 percent³. Of 49 low income countries for which data is available, Cambodia ranked sixth lowest in total public spending proportional to GDP, out-performing only the Democratic Republic of Congo, Haiti, Sudan, Liberia and Myanmar (see Taliercio 2006 p. 4).

Over this period, inflation has remained low and there is no evidence that public spending has crowded out private sector investment. In other words, there remains considerable “fiscal space” within which the Government could significantly increase public spending before there is any risk of jeopardizing macroeconomic stability. Indeed, it appears that the over-riding priority in Government’s fiscal policy is to sustain macroeconomic stability, and that it pursues this—to the detriment of other objectives—first and foremost by containing expenditure within a (very restrictive) revenue envelope.

To spend more, however, the Government must first raise more revenue

For public spending to be an effective tool of pro-poor, pro-equity Government strategy, then, requires that significantly more revenue is collected. Improved revenue collection is emphasized because increases in the other sources of finance potentially available for public spending (namely ODA and borrowing) are presently either not likely or not advisable (Box 8.6) and because revenue collection in Cambodia is very low in comparison to other low income countries. From 1995 to 2004, revenue-to-GDP averaged 6.8 percent in Cambodia, compared to an average of 14.2 percent for other low income countries, placing Cambodia third from bottom amongst these 51 countries (Figure 8.1). From 2003 to 2005 Cambodia’s total revenue averaged 11.1 percent of GDP (7.1 percent tax revenue, 2.8 percent non-tax revenue).

³ In these calculations, revenue figures do not include ODA, with the exception of budget support.

Box 8.6 Non-revenue financing of public spending*Official development assistance (ODA)*

Cambodia currently makes heavy use of ODA, which finances nearly half of total spending. Given the highly concessional nature of assistance available to Cambodia, it makes sense for the Government to seek and utilize as much ODA as possible to finance its spending program. In the short term, however, Cambodia has little control over the level of aid flows, which are largely determined by exogenous factors (e.g. aggregate amounts of ODA made available by donors). Some sources (viz., those from the World Bank, ADB, and the US) are influenced by RGC performance indicators, and as such could be influenced by the Government if it further improved its policy and institutional environment. However, there is a problem with lagged measures of performance, as current levels of ODA are determined by performance in previous years. As a result, it seems likely that at best, Cambodia's total "traditional" ODA would likely remain about the same in real terms over the next five years. Cambodia's amount of ODA per capita (c. US\$ 46 in 2006) is already very high in comparison to other low income countries (e.g. the Sub-Saharan Africa regional average of \$28 per capita). However, it is possible that aid from "non-traditional donors," such as China, could increase. In 2006 China committed a relatively large sum of US\$ 600 million to Cambodia (although this amount includes quasi-concessional project financing over a multi-year period as well as private investment). While it is not possible to estimate with any precision the amount given in grant aid from China and other non-traditional donors on an annual basis, it is reasonable to assume that this amount will increase over the next three to five years.

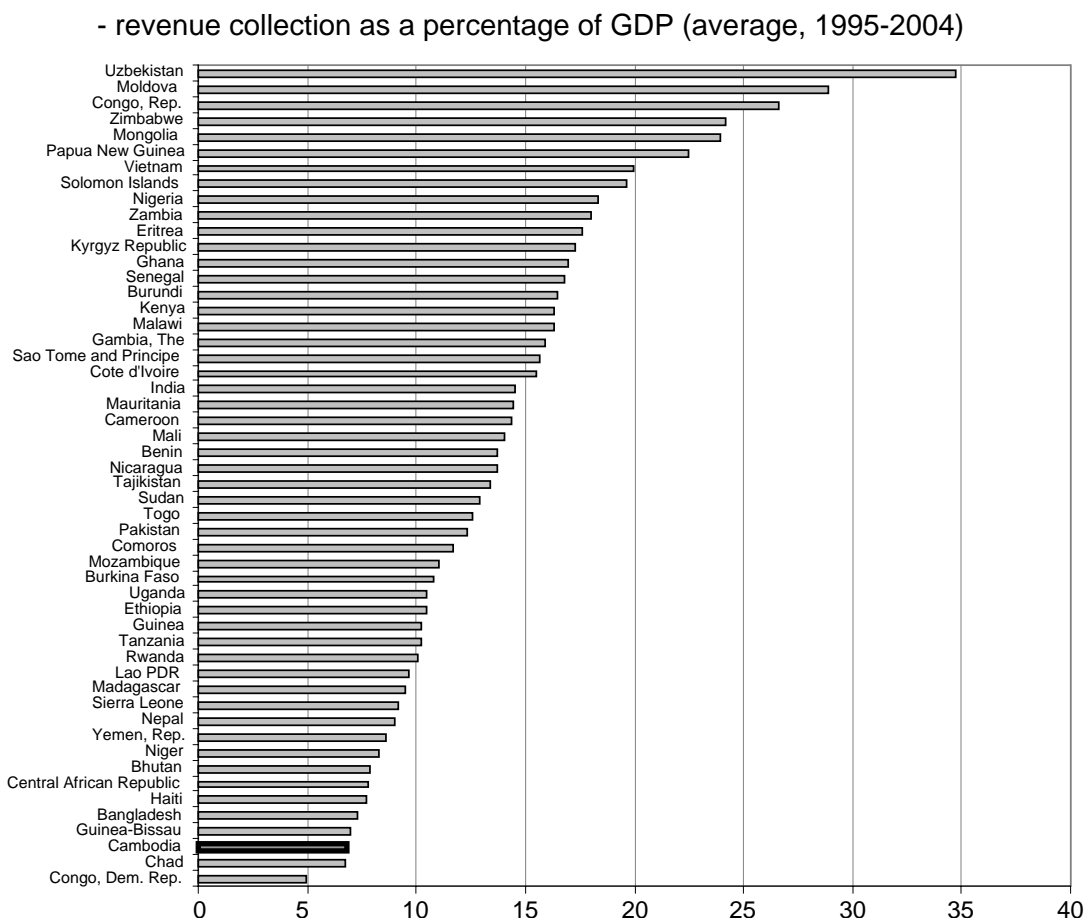
Debt

The third source of financing available to the Government is foreign and domestic debt. Cambodia's relatively high debt stock is largely due to a historical legacy of borrowing from the US (1970s) and USSR (1980s): the recent debt policy of the Government has been prudent. All new external debt is concessional, and domestic debt, at only 3.4 percent of GDP, is contracted on amounts and terms conducive to sustainability. Overall, Cambodia's debt is sustainable: although the risk of debt distress is high, a concessional rescheduling with both the US and the Russian Federation would be likely to bring sustainability indicators back within safe limits. There is no evidence that debt policy is inappropriate in terms of public expenditure policy. In fact, the Government has recently started to consider borrowing small amounts on less concessional terms for high return infrastructure investments.

This comparison would suggest that, rather than worrying that excessive taxation may generate economic costs, Cambodia in fact can and should increase revenue collection in order to finance higher levels of spending. A package of administrative and policy measures (e.g. introducing a modern property tax, raising the VAT rate, and improving tax and customs administration) is needed to boost Cambodia's revenue to GDP ratio beyond its currently stagnated level. Similarly, the current structure of tax revenue is unlikely to be overly distortionary and while Cambodia's non-tax revenue structure (composed mainly of user fees and concession charges) is not notably well designed, the problems with this structure (particularly the concession charge component) is that it tilts

in favor of under-charging (often generating inefficiencies in the overexploitation of natural resources due to low pricing structures), not that it constitutes an excessive charge upon the private sector. In summary, neither the magnitude nor the structure of revenue collection rank as serious problems for economic development.

Figure 8.1 Cambodia ranks 49 out of 51 low income countries for revenue collection



Source: Staff estimates based on World Bank live database

Efficiency gains are possible at either present or higher levels of spending

If the first challenge in making public spending effective as a tool for promoting equitable development (or indeed any other policy goal) is to improve revenue generation, fiscal space can also be expanded by improving the efficiency of spending (i.e. seeking to achieve the same level of output with less input, or greater output with the same input). Weaknesses in PFM systems not only create unacceptable levels of fiduciary risk but also impose high costs in terms of allocative and operational inefficiency. Examples of wasteful spending range from moonlighting civil servants to relatively expensive administrative overhead costs to misdirection of financial resources

to non-priority uses. Cash-based payments have been a major constraint: budget execution has suffered from delays and unpredictable release of funds, undermining operational planning and resulting in the build-up of arrears. The system is plagued by gate-keeping and deficient accounting and reporting systems, leading to a weak control environment and increasing opportunities for corruption. Cambodia's system ranks below average for low income countries, indicating the need for substantial upgrading.

The Government's *Public Financial Management Reform Program* (2005-2015) is focusing first on making the budget credible and reducing fiduciary risk (by improving budget planning and execution and strengthening the control environment). The Program is increasing use of the banking sector, improving planning and prioritization in cash management, and developing a financial management information system (FMIS). Strengthening the internal and external control environment will require not only an appropriate legal framework but also an enhanced public accounting system, a culture of legal compliance, ethical and professional standards, and appropriate oversight arrangements. In this context the National Assembly is strengthening its oversight capacity so that it can promote greater accountability regarding the use of public funds.

Moreover, in order to reach RGC goals of poverty reduction and equity, spending needs to be linked 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.

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. 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.

Equity and patterns of public expenditure

Having concluded that increasing the *level* of spending is possible and desirable, it is then necessary to examine the *composition* of public spending, in terms of its allocation to sectors and the balance between capital and recurrent spending.

Spending has shifted from defense to development; but more money is needed for public spending that promotes growth

Table 8.1 summarizes trends in sectoral allocation, expressed in terms of spending as a percentage of GDP in that year⁴. These figures show that the share allocated to “core Government” have declined over the last five years. This reflects the reduction by a third in spending on defense and security, but also the extremely low share allocated to the judiciary. Spending on social services is now considerably higher than ten years ago (even if it has dipped slightly in relative terms in the last two years); but allocations to the economic sectors—agriculture, transport and others—has remain virtually unchanged in percent-of-GDP terms, and about half of the level of social sector spending.

Table 8.1 As core Government costs have been contained, developmental spending has increased

a. Government-executed expenditure by summary function, 1996-2005 (percentage of GDP)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 ¹	2005 ^{1,2}
Core Government	6.1	5.8	6.3	5.4	6.4	5.6	6	5.5	4.5	3.7
Economic Services	1.1	1.3	0.8	1.4	1.4	1.8	2.1	1.6	1.2	1.3
Agriculture	0.2	0.2	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.4
Transport	0.3	0.4	0.2	0.3	0.6	0.7	0.9	0.6	0.5	0.5
Other Economic	0.5	0.7	0.5	0.9	0.5	0.7	0.7	0.5	0.3	0.4
Environmental protection	0	0	0	0	0	0	0	0	0	0
Rural Development	0.1	0	0.1	0.1	0.1	0.2	0.4	0.5	0.4	0.3
Social Services	1.9	2	1.7	2.6	2.7	3.1	3.5	3.4	3.2	2.9
Health	0.5	0.5	0.4	0.9	0.7	0.9	1	1	0.9	1
Education	0.9	0.8	0.9	1.1	1.2	1.4	1.7	1.6	1.5	1.4
Community & Social Services	0.5	0.6	0.5	0.5	0.8	0.8	0.8	0.8	0.7	0.5
Humanitarian / Relief	0.6	0.1	0.2	0.4	0.3	0.2	1	1.8	0.8	1.9
Total	9.8	9.2	9	9.9	10.9	11	12.9	12.7	10.1	10.1
Share of Total (RGC plus ODA)	0.43	0.45	0.39	0.47	0.46	0.48	0.51	0.52	n/a	n/a

⁴ Given that ODA has comprised a significant percentage of expenditure over the last decade, it is worth looking at the picture for total expenditure (Government-executed plus externally-financed) as well as, within this, specifically Government-executed expenditure (as presented in the table here). The former has been fairly stable, averaging around 25 percent of GDP in any given year; the latter has been increasing since 2000, and more erratic as a percentage of GDP, ranging between a low of 9 percent in 1998 to a high of 12.9 percent in 2002.

b. Treasury-executed spending by function, 1996-2005 (percentage of total)

Function	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005 ²
Core Government	62.6	63.2	69.4	54.7	58.9	51	46.6	43	44.6	36.7
General Administration	17	15.7	26	19	29.1	25.7	22.2	24.6	23.9	18.4
Defense	32.5	32.7	29.5	25.2	20.2	16.5	12.3	11.6	12.7	11.4
Security	12.8	14.6	13.7	10.1	9.3	8.5	6.6	6.3	7.5	6.4
Judiciary	0.3	0.3	0.2	0.3	0.4	0.4	5.4	0.5	0.5	0.5
Economic Services	10.8	14.1	9.3	14.2	12.6	16.9	16	12.9	12.2	13
Agriculture	2.1	2.6	1.7	1.9	2.3	3.9	3.3	3.4	3.2	4.1
Transport	3.1	4.1	1.8	2.6	5.1	6.4	7.2	5	5.4	4.7
Public Works	2.6	2.6	1.2	2.2	4.7	5.4	7	4.6	5.1	4.3
Other Transport	0.5	1.5	0.5	0.4	0.4	1	0.2	0.3	0.3	0.4
Other Economic Services	5.5	7.3	5.7	9.5	4.8	6.1	5.1	4.2	3.2	3.7
Environmental Protection	0.2	0.2	0.1	0.2	0.3	0.4	0.4	0.4	0.4	0.4
Rural Development	0.5	0.4	0.6	1.2	0.8	1.8	3	3.6	3.8	2.7
Social Services	19.5	21.2	18.8	26.4	24.8	28.1	27	26.8	31.7	28.7
Health	4.8	5.9	4.2	9.4	6.7	7.9	7.9	7.6	9.1	9.6
Recreation, Culture & Religion	0.6	0.8	0.6	0.8	1.8	1.9	1.4	1.4	1.2	1.3
Education	9.1	9.1	9.4	11.4	10.7	12.9	13.1	12.7	15.2	13.7
Social Protection	5	5.5	4.6	4.8	5.7	5.4	4.5	5	6.1	4.1
Other	6.5	1	1.9	3.5	2.9	2.2	7.5	13.8	7.7	18.9
Debt	6.5	1	1.9	2.5	2	1.8	1.7	6.5	3.9	5.5
Capital Expenditure ³	-	-	-	-	-	-	4.9	5.8	3.3	7.7
Other not classified	-	-	-	1.1	0.9	0.5	0.9	1.5	0.5	5.7
Total	100	100	100	100	100	100	100	100	100	100

Source: Based on World Bank estimates and MEF TOFE, presented in Taliercio 2006 pp. 12-14.

Notes: ¹ Only government expenditures are presented for 2004 and 2005 (i.e. ODA figures are not available).

² The reported figures are budget plans for year 2005.

³ The way government budget expenditures are reported changed in 2001. Up until then, all capital expenditures were reported under the corresponding ministry. Thereafter, some of the capital expenditures that were reported by the government were not allocated across the ministries and the remainder is presented separately.

The improvements in service delivery and human development outcomes (and likely positive impact upon productivity and growth) described in chapter 6 attest to the positive results achieved through rising social sector spending. (Rising household spending on schooling and healthcare, combined with improved sector-level expenditure efficiency, have of course also contributed.) By contrast, at \$88.5 million in 2004 (constant 2005 prices), spending on economic sectors (agriculture, transport and rural development) is inadequate to meet the pressing need for spending on public goods to stimulate rural-based, labor-intensive, poverty-reducing growth of the kind needed to meet the Government's goals for growth and poverty reduction. Under-spending on the economic sectors is an underlying weakness that needs to be addressed, both by the Government and its partners.

However, to derive more detailed prescriptions for the sectoral allocation of public expenditure on the basis of presumed effects on growth and distribution (and the interaction between these two) is extremely hard (see Box 8.7). Thus the broad approach of the Government at present this time—namely, to stabilize social sector spending at current levels (relative to GDP) and to focus increases on the economic sectors (agriculture and infrastructure)—makes good sense at this point. It should be noted however that increases on current spending levels in either the more advanced social sectors *or* the economic sectors is likely to a decline in the overall efficiency of spending,

unless some of the increase is dedicated to increasing capacity, particularly through civil service reform. It is clear that the ministries of agriculture, rural development, and public works and transport are in need of considerable capacity development before across-the-board increases could confidently be made in their budgets (see World Bank, 2003)⁵.

Another way to formulate the problem of where best to allocate public spending so as to promote growth and poverty reduction (including through measures that promote equity) is to phrase the issue in terms of a choice between *investing in institutions* (core functions of the state such as the judiciary, the civil service, and the overall regulatory regime) versus *investing in physical assets* (such as roads, schools, and irrigation systems). This has implications for the balance to be struck between capital and recurrent spending: building public sector institutions, defined either narrowly or broadly, is likely to imply increased prioritization of recurrent spending relative. The mapping is obviously not perfect—infrastructure requires recurrent spending on maintenance to retain its value; correspondingly, building core public sector capacities may require some one-off investment in, for example, training facilities and curriculum development—but the point remains: a serious effort to build core state capacity strongly implies increasing spending on recurrent uses, and most notably, committing significantly more funds to public sector salaries (see Box 8.8).

Box 8.7 Difficulties in identifying optimal allocation for goals

Analytically, using expenditure policy to meet outcome goals (e.g. growth and human development targets in the NSDP) is not so straightforward. The principal problem can be framed in terms of the *complementarity of expenditure*, both in functional and economic terms. Thus, a rural road in district X might do more to improve enrolment rates than building another school. The impact of infrastructure spending (roads, water, energy, etc.) on social outcomes is increasingly understood as highly complementary to social sector spending. This makes it difficult to provide robust high level policy recommendations about the allocation of spending across major functional categories

The second major analytical complexity—*complementarity of economic types of expenditure*—relates to the fact that absorptive capacity is endogenous. That is, greater spending on wages, management, and facilities could increase absorptive capacity, thus justifying greater investment in sector projects and programs. Writ large, the trade-off between public spending and the capacity of the public sector to spend is a difficult one to assess, especially in post-conflict settings with current tools. Despite these difficulties in assessing the relative merits of different functional categories and direct as opposed to capacity-building spending, this is what the Government and National Assembly in practice must do every year.

⁵ Tanzi (2004) provides an overview note on measuring efficiency in public spending. The quantitative comparative assessment of sectoral efficiency is still at an early stage of analytical development. The recent application of techniques such as Free Disposal Hull (FDH), however, is promising, and could be considered as follow on work to this report. See Herrera and Pang (2005) for a panel data analysis of public spending efficiency in developing countries. Herrera and Pang (2005) also find that higher spending is correlated with lower efficiency, and in particular with respect to higher shares of the wage bill to total spending.

Box 8.8 Civil service salaries and development outcomes

Arguably, Cambodia might generate higher returns from recurrent ‘investments’ in the civil service as compared to a given road project. This issue—the returns to investing in institutional software rather than economic hardware—is a topic of considerable debate: the IMF notes that “In low income countries, it is not obvious that public investment should take precedence over current spending”, while the World Bank observes that “Governance is a key determinant of the efficiency and effectiveness of public spending” (see World Bank 2003 for a discussion of this issue in the Cambodian context). A better paid and managed civil service will reduce the incentive and opportunities for corruption, which a number of analysts have found directly reduces the productivity of public investment (see Tanzi and Davoodi (2002) cited in IMF, 2006).

There is not a clear consensus on this, however. Gupta et al. (2004) present a different perspective, concluding that achieving fiscal consolidation by reducing the wage bill, as opposed to capital spending, results in higher growth rates. On this analysis, then, capital investments are still to be preferred to public sector salaries. However, analysis strongly suggests that Cambodia is not yet at a stage where it is desirable to reduce the wage bill.

The conclusion that there is now also ample literature on the link between governance and growth similarly provides no clear practical guidance. The importance of governance to the efficiency of public spending would suggest, on the one hand, caution in urging the creation of fiscal space in countries where governance is weak: but, on the other, it also implies the need to improve governance in order to enhance the overall impact of public spending, most especially in countries where fiscal space will be rapidly expanding (e.g., as a result of the discovery of natural resources, as in Cambodia, which have been found to have a strong, negative effect on growth by undermining the quality of institutions: Sala-i-Martin and Subramanian, 2003).

Sources: IMF 2004 p. 23; World Bank 2006.

Given the serious problems afflicting the civil service—low pay, low skills, and thus low capacity—strategic civil service reform will have to be accelerated in the short term and carried out over the medium term if the RGC’s vision of poverty reduction is to become reality (World Bank, 2003). Cambodia’s 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 deployed well in high priority sectors; and strengthening civil service management, to guarantee that human resource expenditures are subject to controls and linked more closely to the budget formulation process. Indeed, one of the principal risks to the NSDP is the capacity of the civil service to deliver.

Though the details of Cambodia’s pay reform have yet to be developed, it is clear that increasing civil service pay will require a large amount of additional resources. This ‘investment,’ which is recurrent in nature, is undoubtedly one of the highest priority uses for Cambodia’s future petrochemical revenues (assuming efforts are also made to improve the management of the civil service). Yet there is no analytical tool that allows for a cost-benefit assessment of the impact of building the institutions of state through higher pay versus investing in roads and school buildings. Nonetheless, a civil service pay reform policy clearly needs to be prepared to lay claim to, at the very least, the minimum amount of resources needed to establish a functional civil service in the priority sectors, subject to the recommended wage bill in the medium term macroeconomic

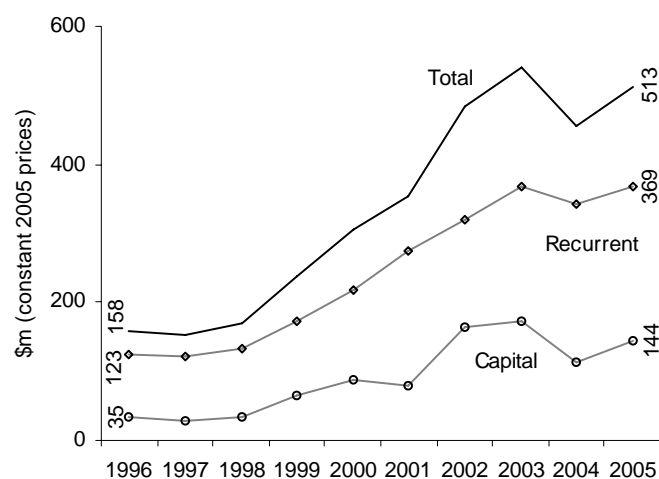
framework. A sound strategy for boosting wage spending needs to be a major feature of Cambodia's medium term expenditure policy.

Building vs. sustaining improvements

The other way to examine the composition of public spending and its likely contribution to promoting an equitable growth path is to examine the balance between investment or capital spending (that is, spending on new buildings, equipment, and so on) and recurrent spending (regular expenditures for public sector salaries, maintenance costs, and so on). There is a pressing need to increase spending on the maintenance of public sector infrastructure investments. As a post-conflict country, Cambodia has an extremely long list of urgent investments needed to rebuild the country's physical and human capital. At the same time, it is highly inefficient to use limited resources nearly exclusively on new investments (e.g. a new or rehabilitated road), which then rapidly degrade for lack of recurrent maintenance spending, necessitating a further round of extremely expensive investment spending.

Overall spending has risen over three-fold in real terms between 1996 and 2005 (Figure 8.2, Table 8.2): this rate of increase has been roughly similar for recurrent and capital spending, although capital spending has been more erratic. Averaging 2 percent of GDP over decade 1995-2004, Cambodia's capital spending has been less than half the low-income country (LIC) average (4.9 percent), placing it eighth from bottom out of 30 LICs for which data is available. This helps explain Cambodia's extremely low rates of electrification; poor penetration of telecommunications; and road and irrigation networks which are amongst the lowest in the region (World Bank 2004, 2006).

Figure 8.2 The economic classification of public spending, 1996-2005



Source: MEF TOFE reports

Chronic and severe public-sector underinvestment in infrastructure are also likely to have serious effects on inequality as well as aggregate growth (Box 8.9). Throughout this report, numerous statistics point to the existence of very pronounced geographical inequalities. Although other factors (e.g. soil quality, length of time elapsed since armed conflict ended in the locality) are also at work in explaining differences in spatial averages, a key explanatory factor is the difference between core and well-connected parts of the country on the one hand and remote, isolated parts of the countryside on the other. In lowland areas close to towns and national roads, inhabitants have access to more varied and extensive markets, and enjoy proximity to schools and healthcare

facilities; in poorly-connected, typically upland areas, opportunities and service coverage are much more limited. Improving total spending on basic infrastructure and, where appropriate, targeting investments to poor areas could play a powerful role in equalizing opportunities and, eventually, outcomes.

If it is accepted that public spending on infrastructure can generate high returns and positive externalities (World Bank 1996, 2005; Aschauer 1989), it is important that Cambodia develop an effective investment appraisal system to maximize the rate of return on public investments. This should also serve to identify the budget allocations that need to be set aside for maintenance of new investments. At present, maintenance expenditures are extremely low, covering probably only two-thirds of what is needed to sustain the value of existing investments.

Finally, while the public sector wage bill has increased from \$39m to \$100m, this is below the rate of overall or recurrent expansion, with the result that the salaries and allowances fell from about one third to one quarter as a share of total recurrent spending. The inadequacy of pay for public servants, and the perverse, anti-poor outcomes that it gives rise to, are readily apparent to most Cambodians.

The somewhat unhelpful conclusion from analysis of public expenditure policy is that levels of spending on *all* sectors and categories—including the construction and subsequent maintenance of infrastructure, civil service salaries, and running costs—are far too low to meet the level of need, achieve efficiency in implementation, or effectively translate policy goals and priorities into economic and social outcomes. There is however two good reasons to be optimistic about the prospects that public expenditure could, in the medium term, be an effective instrument for the Government's goals of equitable development. The first is the progress in the PFM Reform Program. The second is the recent discovery of significant reserves of oil and gas in Cambodian territorial waters, which greatly expands the fiscal space available to the Government. It does however come with its own set of complications and risks.

Box 8.9 Infrastructure and equality: cross-country and locality findings

Calderon and Serven (2004) argue that infrastructure spending can reduce income inequality by having a disproportionate impact on the poor by connecting them to economic activities (e.g., roads that link poor agricultural areas to markets increase the value of the poor farmer's assets) and aiding in human capital development (e.g., roads have been shown to correlate positively with school attendance, and clean water can have an enormous impact on child mortality). Calderon and Serven (2004) found that both infrastructure stocks and the quality of their services have a negative and significant impact on the Gini coefficient using panel data for over 100 countries spanning the years 1960-2000.

At the other end of the scale spectrum, the MOPS research "suggests that investment in making communities as accessible as possible is critical and should continue, preferably as a national and coordinated initiative rather than on the current, often ad hoc basis, which sees roads constructed, often by NGOs or donors, but then not maintained; or where road access is controlled by private interests, as is the case in Babaong. Accessibility will in turn facilitate access to and demand for new markets, services, and opportunities including for employment and trade" (CDRI 2007b, forthcoming).

Table 8.2 Spending has risen three-fold since 1996

- Treasury-executed civil administration spending by economic category, \$m constant 2005 prices (indexed, 1996 = 100, in italics)

Budget Chapter	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Sub-Total	123.3	122.3	134.4	172.8	217.2	274.2	318.5	367.2	341.8	369.0
Current	100	99	109	140	176	222	258	298	277	299
10: Salaries and Allowances	39.1	41.2	42.8	52.6	60.6	64.0	83.0	89.5	88.8	100.3
	<i>100</i>	<i>105</i>	<i>109</i>	<i>135</i>	<i>155</i>	<i>164</i>	<i>212</i>	<i>229</i>	<i>227</i>	<i>257</i>
11: Operating Costs	50.5	50.7	52.9	74.1	101.6	130.7	120.1	132.2	117.1	110.6
	<i>100</i>	<i>100</i>	<i>105</i>	<i>147</i>	<i>201</i>	<i>259</i>	<i>238</i>	<i>262</i>	<i>232</i>	<i>219</i>
12: Subsidies - provincial admin.	5.4	5.2	4.5	4.1	5.7	6.9	15.4	29.2	29.5	31.2
	<i>100</i>	<i>96</i>	<i>83</i>	<i>76</i>	<i>106</i>	<i>128</i>	<i>285</i>	<i>541</i>	<i>546</i>	<i>578</i>
13: Special prog. agreement	0.1	0.3	8.1	1.4	3.2	20.5	37.7	38.0	39.4	43.2
	<i>100</i>	<i>300</i>	<i>8,100</i>	<i>1,400</i>	<i>3,200</i>	<i>20,500</i>	<i>37,700</i>	<i>38,000</i>	<i>39,400</i>	<i>43,200</i>
Other current (20, 30-2, 40-1)	28.1	24.9	26.1	40.6	46.1	52.0	62.1	78.3	67.0	83.7
	<i>100</i>	<i>89</i>	<i>93</i>	<i>144</i>	<i>164</i>	<i>185</i>	<i>221</i>	<i>279</i>	<i>238</i>	<i>298</i>
Sub-Total Capital	34.5	29.3	34.0	63.8	89.0	80.1	164.7	172.1	113.0	144.3
	<i>100</i>	<i>85</i>	<i>99</i>	<i>185</i>	<i>258</i>	<i>232</i>	<i>477</i>	<i>499</i>	<i>328</i>	<i>418</i>
50.1 Construction & Equipment	16.7	22.5	23.3	53.3	63.2	53.2	126.9	93.1	54.2	84.5
	<i>100</i>	<i>135</i>	<i>140</i>	<i>319</i>	<i>378</i>	<i>319</i>	<i>760</i>	<i>557</i>	<i>325</i>	<i>506</i>
50.2 Counterpart funds	3.1	5.0	9.2	7.5	23.0	14.8	27.9	25.0	27.9	24.4
	<i>100</i>	<i>161</i>	<i>297</i>	<i>242</i>	<i>742</i>	<i>477</i>	<i>900</i>	<i>806</i>	<i>900</i>	<i>787</i>
Other capital (50.3, 52, 53)	14.7	1.8	1.5	2.9	2.8	12.2	9.8	54.0	30.9	35.4
	<i>100</i>	<i>12</i>	<i>10</i>	<i>20</i>	<i>19</i>	<i>83</i>	<i>67</i>	<i>367</i>	<i>210</i>	<i>241</i>
Total	157.8	151.6	168.4	236.6	306.1	354.3	483.2	539.3	454.8	513.3
	<i>100</i>	<i>96</i>	<i>107</i>	<i>150</i>	<i>194</i>	<i>225</i>	<i>306</i>	<i>342</i>	<i>288</i>	<i>325</i>

Oil wealth and equity

The major opportunity on Cambodia's fiscal front is the discovery of significant amounts of offshore petrochemical reserves (Box 8.10). The magnitude of these oil and gas assets has the potential to transform Cambodia's fiscal situation. Indeed, the magnitude of the discovery is such that it raises questions about to what extent Cambodia should continue to pursue growth of non-oil related revenue sources. Maintaining the current revenue to GDP share but augmenting it considerably with oil-related revenue could be sufficient to generate the resources needed for the RGC's medium to long term

Box 8.10 Current estimates of Cambodian petroleum reserves

The RGC has demarcated six offshore blocks for licensing. In addition, there may be deposits in the Overlapping Claims Area (OCA), under negotiation with Thailand, and in several inland blocks. To date, contracts have likely been awarded for five off-shore blocks (A-E), and E is under negotiation. According to the Cambodia National Petroleum Agency (CNPA), the block A contract area contains an estimated 700 million barrels of oil and 3-5 trillion cubic feet of natural gas. Estimates for other blocks are not yet available, and it will take another 1-2 years before there is good data on Blocks B-E. In Block A CNPA estimates that oil production will start in 2009 and gas production in 2011.

program.

Estimates show that oil revenue will exceed all current revenue sources: 500 million barrels of recoverable oil would yield an annual peak revenue stream to the government of more than \$700 million (the revenue stream peaks four years after the start of production), equal to about 11 percent of GDP in 2005.⁶ Estimates at this point, however, are highly uncertain due to imprecise estimates of Block A's volume (Chevron is currently conducting additional exploratory tests). The price of oil is also highly volatile over time and, while high now, might decline over the next decade to a somewhat lower level. At projected future oil prices closer to today's price (about US\$ 60 per barrel), annual revenue from Block A alone could easily exceed US \$ 1 billion on an annual basis (which would represent about 15 percent of 2006 GDP). If other blocks also turn out to be commercially viable, government revenue would increase further, but it is too early at this stage to speculate on precise amounts. Thus, at this point a forecast of around 10 percent of GDP per annum from Block A seems reasonable, and would, in effect, double Cambodia's revenue-to-GDP ratio. If one other block (of the other five) contained as much as Block A, revenue to current GDP could triple.

Even if actual revenue is less than current estimates, oil and gas will completely transform Cambodia's fiscal space. It is possible that the revenue to GDP ratio could double over a 3-4 year period, which would put great pressure on the public expenditure management system to deliver resources more efficiently.

Managed well, this has the potential to improve state spending on economic and social development and accelerate progress towards Government development goals. If managed in a strategic and accountable manner, these funds could help Cambodia escape least-developed country status in a much shorter time frame than has previously been thought possible. However, global experience suggests that petrochemical wealth may equally well result in a "resource curse": in more cases than not, the discovery of oil has greatly exacerbated inequalities within countries and actually *reduced* rates of growth and poverty reduction. This pattern is usually explained in terms of the effect of mineral wealth in undermining a state's accountability to its citizens: a government that obtains all the money it needs from mineral rents has no need to collect (or account for) tax (and so less reason to see itself as accountable to its citizens), and lacks incentives to invest in reforming state institutions or fostering broad-based growth. These problems are more pronounced in countries with low state capacity and relatively weak formal institutions, and are at their worst in post-conflict countries in which the levels of transparency and accountability are very low and state-society relations have been shaped by a tradition of authoritarianism and extraction.

Nigeria, where an average of \$12 billion per annum in oil wealth over a thirty year period has fostered pervasive corruption and done nothing to promote growth or reduce poverty is the most obvious example but far from the only one. The Nigerian experience contrasts markedly with many east and southeast Asian economies (e.g. Japan, Korea, Taiwan or Thailand) that are *not* richly endowed with mineral wealth, but which have sustained broad-based, poverty-reducing growth over several decades.

⁶ This estimate is based on a constant projected world oil price of \$43.75.

An additional concern is that oil revenue might trigger “Dutch disease” effects. Foreign exchange generated from the oil sector could result in an appreciation of the real \$/riel exchange rate, which would weaken the competitiveness of traditional exports, notably the garment sector. This sector has served as the main wage employer of unskilled (and mainly female) labor and as such has been a key factor in enabling growth with static consumption inequality since the late 1990s. It is thus important for sustained poverty reduction and equity in Cambodia that the potential–macroeconomic effects associated with oil wealth are anticipated and avoided.

There is thus good reason to be cautious about predicting the impact of any future stream of petrochemical revenue on the Cambodian economy and the prospects for Cambodia’s poor. Carefully designed institutional mechanisms that promote transparency and accountability in the use of this national asset will be critical if oil wealth is to help rather than hinder Cambodia’s escape from the ranks of least-developed nations (Vallely *et al* 2004; UNDP 2006). The potential for a dramatic increase in revenues adds further urgency to the need for the strengthening of public financial management—and sharpens the case for improving transparency and accountability in order to combat corruption in public life.

Recommendations

To improve the capability of the Government to use public expenditure policy to promote growth and equity objectives, a number of clear priorities emerge:

Increase fiscal space by increasing revenue. Cambodia’s fiscal space is quite constrained by its low revenue effort, the impact of which is noted across all categories of spending. Given the discovery of very large off shore reserves, Cambodia’s fiscal picture is likely to change very abruptly. Oil revenue will double or triple the revenue to GDP ratio, thus completely transforming Cambodia’s fiscal space and opening up the possibility of increasing spending across several types of spending simultaneously.

Increase the budget allocation for economic sectors (agriculture and infrastructure); within the general government sector, reallocate from general administration to the judiciary. Cambodia’s economic sectors are still starved of the resources needed to make the difference between lower and higher growth. Though the RGC has increased spending in both agriculture and infrastructure, the overall increases have been meager. Similarly, sustained increases are needed to transform the budget-starved judiciary. In both cases, however, there is a very important caveat: spending increases should proceed only after sectoral strategies have been developed and management has improved. While economic sector management is being developed, spending increases could focus on capital investments (see below).

In economic terms, the RGC should increase capital spending, maintenance, and the wage bill.

Increased capital spending is needed to take advantage of the high return projects (principally in infrastructure and agriculture). It should however follow the development of project appraisal capacity (an investment appraisal unit based on suitable methodologies), which is currently sorely lacking.

Specifically in terms of ODA, donors should reallocate from donor-driven free-standing technical cooperation (FTC) to capital spending where sector wide approaches (SWAs) do not yet exist; or use FTC to set up SWAs, which seem to be the best mechanism in Cambodia for moving toward sustainable, capacity-enhancing, Government-led reform programs. FTC in the absence of SWAs seems to be generally quite wasteful and in most cases these resources could be more productive on the capital side.

The RGC also clearly needs to increase public sector wages as the cornerstone of civil service reform. This is likely to require a significant increase in the civil administration wage bill. The RGC is preparing a new pay policy for 2007, which will provide the basis for an increase in the wage allocation. This should be regarded as a priority claim on scarce resources. Building institutions in Cambodia is as much of a priority as building physical assets.

Increase maintenance spending. Maintenance spending is inadequate. Physical assets are deteriorating in many cases, undermining the high potential of capital spending to deliver sustained growth. Maintenance spending should be increased dramatically to about 1.5 percent of GDP.

Reduce wasteful spending. The budget is characterized by pockets of inefficient spending, in some cases due to high administrative overheads, in others due to the perverse effects of low wages on other spending categories (e.g., the operations and maintenance budget in education being used to pay teachers' special allowances). In still others it reflects the lack of a coherent sector strategy. The RGC should conduct an efficiency review to locate these pockets of waste.

Legal and judicial institutions and access to justice for the poor

The system by which justice is mediated is an important underpinning of economic and social development (see Box 8.11). Capable, honest and autonomous legal and judicial institutions have the potential to limit the emergence of gross inequalities in power between the state and the citizenry, or between the rich and the poor. Independent courts enforcing the principle of equality before the law should serve as a limit upon the exercise of unrestrained power by the executive or abuse of position by officials. Equal treatment by the courts in the event of a dispute over ownership or contracts is a key component of equality of economic opportunity, and an efficient justice

Box 8.11 Justice systems play a crucial role in long-term development

The 2006 World Development Report summarizes international experiences on the importance of legal and judicial systems as follows:

Legal institutions play a key role in the distribution of power and rights. They also underpin the forms and functions of other institutions that deliver public services and regulate market practices. Justice systems can provide a vehicle to mediate conflict, resolve disputes, and sustain social order. But inequitable justice systems may perpetuate poverty traps by maintaining or reproducing elite interests and discriminatory practices. Equitable justice systems are thus crucial to sustained equitable development.

World Bank 2005 p. 156.

system bolsters commitments to equity in the delivery of public services.

Unfortunately the legal system in Cambodia has yet to fulfill this potential. Severely lacking in capacity and resources and badly affected by lengthy delays, a shortage of legal aid and difficulty in enforcing judgments, the court system (and other elements of the de facto administration of justice, such as the police) are widely perceived to be either deeply corrupted or under the direct control of the executive. A public opinion poll (CAS 2003) found that Cambodians perceived only slight improvement in the performance of courts from 1998 to 2003; and had little or no faith in the courts as institutions of justice, identifying judges and prosecutors as the public officials they were least likely to trust. A more recent survey of popular experiences of corruption in Cambodia suggests the picture has not changed significantly: the courts were seen as by far the most corrupt of all public institutions, followed by the police (CSD 2005). As a result, many Cambodians (and especially poor Cambodians) seek to resolve disputes and obtain justice by working around rather than through the formal institutions of the state (CAS and World Bank 2006; UNDP 2005).

In the absence of equitable rule-based systems for allocating resources and resolving disputes, collective action is a crucial mechanism for improving the responsiveness of the state to the needs of the poor. With pressure on land and natural resources increasing, recent research suggests that there is increasing willingness for villagers to pursue claims, even against people who are rich or powerful (CAS and World Bank 2006). This research finds that the state is not impervious to these claims. Without suggesting that the disputes studied were resolved satisfactorily, it was clear that when villagers had acted collectively they had been able to achieve more equitable outcomes than might otherwise have been the case. This finding echoes that of Nee and Healy (2003) who suggest that the existence of social capital is a major factor in the achievement of pro-poor results from local dispute resolution systems. While acknowledging that it is ultimately the responsibility of the state to ensure the rule of law they note that “local associations working together are already seeing successes” (p.101) and “it is often possible for village associations to obtain justice simply by building a strong network of relationships with both NGOs and government officials at all levels” (p.102).

There is, however, an operational dilemma in these sorts of dispute resolution ‘successes’. In that these cases show collective disputes being dealt with by powerful individuals within the administration, they reinforce the picture of a formal justice system that is of only marginal importance. To the extent that parties were successful in extracting increased responsiveness from the state, they did so largely by putting political pressure on key decision makers and not by relying on the law or seeking access to officially mandated dispute resolution process. Written laws, legal processes or rule-based forms of decision making were notable by their absence and institutions established outside of the patronage system of power were seen as ineffectual. As such, these studies provide few direct insights as to how the rule of law might be established in the Cambodian context.

The findings do, however, place Cambodia in a position that is historically common, given that the model of a modern judiciary emerged in an iterative process, with independence from the executive secured over time in response to a myriad of social, political and economic pressures. This observation supports the case for an interim

institutional approach when thinking about the development of more equitable institutions of justice in Cambodia.

Effective equitable institutions require open (and open-ended) processes

Research on evolving patterns of disputes and dispute resolution in Cambodia suggest there is value in seeking “interim” institutional arrangements, rather than necessarily looking to transplant “international best practice” organizational forms into Cambodia (see Adler *et al* 2007 and Box 8.12 below). This can be illustrated with reference to two cases of policy and institutional reform.

Box 8.12 “Interim institutions” for governance reform

The interim institutional approach provides a method for engaging with situations of deeply entrenched legal pluralism. Acknowledging that such situations limit the effectiveness of state law as a driver of more equitable governance, an interim institutional approach argues that: (i) equitable, rule-based systems for allocating resources and resolving disputes—i.e., the very content and legitimacy of modern institutions of government—emerge and continue to develop because they are subject to ongoing social contest; and (ii) because equitable institutional arrangements for social regulation must emerge through social contest, there will be limits to the extent to which they can be designed *ex ante* on the basis of technical knowledge (i.e., by governance ‘experts’).

Rather than from posing de-politicized solutions to complex political and social contests, an interim institutional approach focuses from the outset on the process whereby more equitable relationships of power might be brought about. In doing this, it asks what spaces exist (or can be created) for the negotiation of development conflicts, and considers how such spaces can be filled with institutions that both respond to the realities of power as it is currently exercised *and* provide the potential to transform these in the direction of greater equity. In other words, rather than emphasizing coherence, consistency or harmony, it understands that social contest is an essential part of institution building.

The interim institutional approach is relatively agnostic with respect to claiming to know (or even worrying about) what the final end-state of any given institution building or reform process might “look like”; rather, it focuses on the more immediate and pragmatic tasks of (i) creating political space for reform; and (ii) taking feasible steps on the basis of processes that are deemed equitable and legitimate in the eyes of the various stakeholders concerned. Supporting and facilitating such political processes should be the primary concern of external development professionals concerned with institution building and reform in environments characterized by pervasive legal pluralism. “Getting the contests right” could be the simplest statement of the programmatic goal and analytical distinctiveness of the interim institutional approach.

Source: Adler *et al* (2007)

The garment industry and core labor standards

Cambodia’s 1997 labor law incorporated several important rights; but it was unclear how the law, once issued, would be translated into practice. Classically, law on the books is enforced through administrative and judicial mechanisms which monitor compliance and/or respond to grievances: actual enforcement is required only infrequently, as anticipation of enforcement gives the law a more general effect. In the context of the

Cambodian workplace, however, the credibility of the law was undermined by the fact that the bodies expected to monitor compliance or respond to grievances (namely, the courts and labor inspectorate) were widely seen as lacking capacity and subject to bias and corruption. Without expectation of systematic enforcement, legislation became just one among several norms shaping working conditions at the enterprise level: as such, the law was in competition with market forces and interaction between the managerial culture of (often China-based) employers, corporate codes of conduct imposed by global buyers, and the culture of spontaneous (and sometimes violent) collective action which emerged in the dormitories housing migrant workers.

The basis for more equitable labor relations began to evolve in the late 1990s with the rapid emergence of Cambodia as a garment exporter. A 1999 US-Cambodia bilateral trade agreement imposed quotas on Cambodia's garment exports; provided that Cambodia would support implementation of "a program to improve working conditions in the textile and apparel sector, including internationally recognized core labor standards"; and, in an interesting innovation, created incentives for improvement by committing to increase quotas as long as working conditions complied with such labor law and standards". The agreement thus created immediate incentives for all stakeholders to implement the labor law: employers would gain business, unions could gain members and the Government could generate both formal and informal revenues from allocation of quotas.

The question remained, however, how the labor standards clause would be implemented, given the lack of credible country systems. The answer was provided by two ILO projects: one to "operate an independent system to monitor working conditions in garment factories" (the monitoring project) and the other to focus on "transparent, fair and expeditious dispute procedures" (the labor dispute resolution project). Box 8.13 summarizes the key issues and features of both projects.

The success of monitoring and dispute resolution efforts in the garment industry seems to have rested on the willingness and ability of key players to engage with the inherently contested process by which rights are attained. Rather than investing primarily in more detailed regulation, administrative or judicial capacity, a number of alternative initiatives were undertaken. In both initiatives, there was an implicit recognition that there may be advantages in supporting the emergence of rights through ongoing processes of contestation and negotiation—where issues of power are at once more overt and more fluid—before trying to fix them in formal legal and enforcement frameworks.

In these circumstances, the Labor Law's main (equity-enhancing) effects have been: (i) establishing a set of (more or less) agreed standards regarding working conditions, which even though not formally enforced, can, in certain circumstances, be drawn upon to legitimate an argument as to what working conditions should be; and (ii) providing a framework for collective action, by legalizing unions, providing for tripartite dispute resolution procedures and legitimizing the right to strike.

Box 8.13 Monitoring and dispute resolution in the garment industry

The ILO-supported *monitoring project* (now Better Factories Cambodia) produces regular reports on conditions in garment factories and is generally agreed to have improved compliance with the labor law in the garment industry. Several factors appear to have contributed. Firstly, the project promoted labor rights through embedded social dialogue, the provision of public information and trade preferences. Secondly, export licenses were granted conditional on an enterprise subjecting itself to ILO monitoring, and the Ministries of Commerce and Labor can deprive employers of their export licenses if they are found to be in continued breach of core labor standards. And, finally, by publishing information on individual factories the system generates pressure for compliance both from others in the industry and their brand name buyers in the US. The willingness of both employers and the Government to continue monitoring after the expiry of the agreements and the quota system in 2004 suggests that the financial incentives included in the trade agreement, while instrumental in *establishing* the system, were only part of the story in sustaining it. Whether monitoring can generate the incentives needed to drive long term improvements without the carrot and stick of access to US markets is yet to be seen.

In the *labor dispute resolution project*, ILO provided technical assistance to the Ministry of Labor in consultation with the union movement and employers' associations. When it was established in 2002, each of the three options available for dealing with labor disputes (negotiated outcomes, referral to the Ministry of Labor for conciliation or enforcement proceedings, or the courts) had significant drawbacks. Systems to handle grievances at the factory level were under-developed, reflected in increasing levels of often violent industrial action. The labor inspectorate suffered from problems common to the Cambodian public sector: limited capacity and low wages led officials to rely upon informal payments from industry to support their livelihoods, undermining their credibility. The courts suffered from similar problems.

There was a range of possible responses to these circumstances. The project could have focused on the establishment of a labor court. However, the ILO concluded that it would be difficult to get classical institutions of the rule of law (those which are both independent and have the power to make binding decisions) to work in Cambodia. Observing previous attempts at legal and judicial reform, it was anticipated that pursuing the rule of law directly would result in either a) stalling the process of setting up a new labor court or b) the capture of the new institution by powerful Government and private sector interests.

As a result, the project focused on creating an Arbitration Council, a tribunal body provided for in the 1997 law but not previously operationalized. As a tripartite body that generally issues non-binding and practically unenforceable awards, the Council is a hybrid between a rule of law institution and a forum for bargaining between management and organized labor. It would appear to have been successful in focusing and legitimating collective action for more harmonious, equitable and constructive industrial relations. The Arbitration Council had received 272 cases as of June 2006, of which 68 percent were reported as resolved successfully.

The Arbitration Council is not without critics. Unions complain that enterprises do not give effect to arbitral awards and that it would be better if the Council could issue binding awards. While generally supportive, employers have on occasions criticized the Council for displaying a pro-worker bias. Institutionally there are questions about whether the Arbitration Council is a viable institution of state absent ongoing donor support.

Source: Adler *et al* 2007.

Thinking of law in this way allowed the development of a dynamic institutional setting for political contests, which began to foster equitable rule-based systems of

governance. These included: (i) support for the capacity of workers to engage in collective action (through unions); (ii) independent monitoring of working conditions within both a local tripartite structure and a framework of incentives and sanctions negotiated at the international level; and (iii) the establishment of credible (though non-binding) dispute resolution mechanisms through which rights could be contested according to agreed 'rules of the game.'

If the case of labor relations illustrates how a more equitable regulatory context can emerge, it also shows some clear limitations of this approach. Firstly, the law is applied almost exclusively in enterprises (primarily garment factories and hotels) which are accountable to an international public through their branding: the extent of any spillover from these sectors into the labor market more generally is unclear. Secondly, these systems operate primarily at the level of the collectivity: in practice, the current regulatory system neither protects workers' rights as individuals, nor does it extend to vulnerable workers, such as those in small and medium sized enterprises producing for local markets. Nevertheless, an evolutionary approach that valued interim institutions would appear to provide a viable first step on a path to hopefully more equitable, formal mechanisms to mediate relations between labor, employees and the state.

From project law to statute in local governance

In the case of labor relations described above, and land titling described in Chapter 2, innovative interim institutional arrangements have been introduced to facilitate the implementation of legislation that was already enacted but remained unconnected to existing, alternative frameworks for managing economic relationships. The case of local governance development provides an interesting contrast. In this case, institutional and policy reform proceeded in advance of legislative change; but with the intention of trialing and demonstrating arrangement that might later be incorporated in legal, political and administrative developments.

In the mid-late 1990s, under the auspices of the Seila program, Cambodia introduced two sets of institutions of local governance, namely the Commune Development Committees (CDC) and District Integration Workshops (DIW)⁷. Seila emerged from the CAREERE (Cambodia Area Rehabilitation and Regeneration) program which between 1992 and 1996 promoted integrated rural development, with a focus on delivering small scale infrastructure in five north-eastern provinces to aid the return and reintegration of refugees. CAREERE was controlled through parallel systems, according to UN and other donor 'project law.' By the time it officially closed in 2006, Seila had become a nationwide program mobilizing funds from both the Government and donors with both governance and direct poverty alleviation goals.

From the start, the program's execution and management arrangements were hybrid, involving aspects of both donor and government regulation. To an unprecedented extent, however, Seila generated an increasingly comprehensive framework of Government laws and regulations. This transformation occurred in part because of a policy decision (expressed in a new set of objectives in 1996) to change the program's purpose and

⁷ Details on the Seila program can be found in Wong and Guggenheim (2005); and on <http://www.seila.gov.kh>.

strategy, which gradually moved from a focus on ‘local development for poverty reduction’ to one primarily concerned with ‘local governance’ (“strengthening institutions at the commune and provincial levels” and financing “participatory development.”), *through which* sustainable improvements in local development would support poverty reduction. Most importantly, Seila aimed to pilot models of “decentralization and deconcentration”. The program thus came to focus expressly on creating broader ‘demonstration effects’ for institutional reform.

The CDC and DIW were explicitly concerned with creating new arenas for political interaction and regulated contest both between citizens and the state, and between government institutions at different levels within the state (see Box 8.14). Eventually, the norms promoted by these interim institutional arrangements came to feature as key aspects of national policies and laws about local governance. The CDCs, and the systems for planning, budgeting and financing that were integral to their operation, found a place in national law when the commune councils were legislatively reconstituted in the LAMC 2001. The CDCs were disbanded immediately following the elections, with their participatory planning functions placed under the Planning and Budgeting Committee and their managerial and governance functions falling under the Commune Council.

Box 8.14 Commune Development Committees and District Integration Workshops

Commune Development Committees (CDCs) were mandated by sub-decree in 1994 as part of an administrative structure for rural development repeated from village to province levels. CDCs were seen by CARERE/Seila as providing an opportunity to experiment with decentralized planning, budgeting and management in service provision. This had both technical and political aspects. CDCs were given discretionary powers to allocate donor funds according to needs expressed and negotiated through village and commune planning processes. From a technical viewpoint, it was expected this would result in a more ‘efficient’ conversion of available local and international resources into useful infrastructure and other investments. The larger ambition, however, was political. The planning and budgeting processes being piloted through the CDCs were pilots for a new regulatory framework for local governance, one which would structure more equitable contests among citizens and their local representatives about how public spending should be prioritized. This process was to build ‘primary accountability’; it was intended to promote the notion that elected leaders—and through them, the administration—should be accountable to citizens for how they made and implemented planning, budgeting and related management decisions.

The District Integration Workshop (DIW) likewise had technical and political ambitions. The DIW was introduced as an annual event in the planning and budgeting calendar. Its goal was to secure from provincial agencies the technical and other support the CDCs required to implement their investment plans. The larger political ambition related to ‘intra-governmental accountability’. In brief, this included the idea that higher level administrative agencies should be accountable to priorities expressed by citizens through their local political representatives. It also included the idea that local choices needed to be negotiated within the policy framework of the government expressed at higher levels.

The DIW process—part of sub-decrees and regulations for commune planning—has not been ‘institutionally embedded’ in the same way as CDC institutions. In fact, it has not yet substantially affected what donors or the administration do beyond the Seila program, despite the fact that roughly 60 percent of all agreements made at the DIW are

financed by projects outside the Seila program. However, the basic precepts of the DIW—that higher level authorities should respond to local priorities, and that these local priorities need to be negotiated with national policy priorities—have become influential. Thus, it might be argued that the DIW has contributed to norms that now feature in an extensive range of project laws, political debates and policy commitments about how Government should behave in Cambodia.

In order to understand how local governance innovations such as the CDCs and DIWs came to be conceived and implemented in Cambodia, it is important to understand the sources of intellectual and political support on which they were able to draw, both internationally and domestically. Internationally, the CDCs and DIWs (and Seila more generally) were both products of and contributors to contemporary international development policy debates about decentralization and ‘community driven development’. In general terms, the case for decentralization was that individuals, households and communities were best placed to determine their needs, and that government functions should be devolved so as to be closely accountable to them.

More specifically, there were two key claims put forward regarding the virtues of decentralization and community-based development (Mansuri and Rao 2004):

- Firstly, it was argued that decentralized and community-based delivery enhanced the *efficiency* of public spending by reducing waste and corruption. Such approaches were thought to increase the share of public funds (Government and ODA) that was converted into useful services (‘productive efficiency’); and to ensure a better match between what people wanted and what Government delivered (‘allocative efficiency’).
- Secondly, and somewhat more contentiously, decentralization was argued to increase inclusion and equity, through more even-handed distribution of public funds across the country (‘geographic equity’) and/or arrangements to ensure that disadvantaged groups in any area get a fairer share of the benefits (‘social equity’).

Within Cambodia, by 1997 Seila had a reputation with Government and donors for an ability to (i) swiftly convert aid money into a very wide range of local investments and (ii) to achieve even-handed working arrangements with the sub-national leadership of the various political factions of the northwestern provinces. These capabilities made rapid aid delivery possible; which in turn meant that Seila had made some notable contributions to peace and reconciliation. For the Government, Seila had demonstrated that it knew how to behave, technically and politically: it was regarded as a dependable, non-threatening contributor to security.

Seila’s reputation as a non-political ‘safe pair of hands’ was matched by its close alliance with Provincial governors and, through a wide experience of sub-contracting arrangements, with the core administrative departments. At the same time, donors were comfortable that this did not put at risk the management systems Seila maintained to safeguard and protect their funds. The program had by the mid-1990s created Province-level systems for coordination and management that were ‘hybrid’. In other words, the formal and informal systems and procedures which enabled the program to operate were severally managed by official government authorities, headed by the Governor (through

what later became PRDC/Ex Comm⁸); by local networks of contractors and suppliers often affiliated with administrative officials; and by local staff contracted to administer UN systems. The program was thus of the Government but still separate from it.

Through its processes and outcomes, Seila was able to provide legitimacy to the political regime. The governing political party, especially after the 1997 crisis, was able to direct benefits down to the politically and electorally important Commune level and thereby bolster their credibility ‘from below’; at the same time Seila could also show to the international community that the Government was serious about local democracy, and thus bolster its credibility ‘from above’.

In summary, CDCs and DIWs helped strengthen political equity, but constraints remain. In assessing the successes and limitations of Seila-induced institutional innovations, it would be naïve to assume these were premised simply in terms of their aim to enhance equity in sub-national governance. Further, in a system characterized by legal pluralism it is clear that to be durable, the new institutional arrangements for local governance need to be underpinned by formal law, administrative conventions, informally sanctioned expectations about what is ‘right’ and ‘fair’, and social norms that support and provide credibility for the kinds of state-citizen relationships and political contests implied by these innovations. These various forums relate in complicated ways: sometimes they reinforce each other, as often they are mutually contradictory. With these caveats in mind, it is possible to draw a number of conclusions regarding the durability/embedding of these interim institutional arrangements.

The institutional arrangements for equitable participation in Commune-level governance—and the reasonable expectation that such governance will be more equitable and pro-poor as a consequence—have survived and strengthened with the transition from project law to Government statute. In 2001 two laws were passed, one for commune-level elections and a second governing commune administration and management (LAMC). This cleared the way for a nationwide election, in 2002, of 1621 Commune/Sangkat Councils (C/SCs)⁹. Proponents of the CDC as a means to more accountable (and thus equitable) local governance felt these laws vindicated Seila’s approach. It is possible to identify at least six aspects of legal conventions, conducive to local political equity, that came into being as a result of the 2001 laws:

- *Territorial authority.* The law empowered CCs to govern the ‘local affairs of its territory’, establishing the legal convention that CCs are the primary instrument of representative democracy, in and through which elected leaders will be made accountable to all citizens for what occurs in their jurisdictions.
- *Equality of political rights and voice.* CCs are comprised of members elected through popular majority. Furthermore, administrative systems provide special provisions to promote social and geographic equity in CC decisions (for example, through quotas for female representatives, and the requirement that each village in the Commune be represented on the Planning and Budget Committee CHECK).

⁸ Provincial Rural Development Committee / Executing Committee.

⁹ A *sangkat* is the urban equivalent to the rural Commune.

- *Rules of contest.* With minor modification, the CDC's Local Development Fund became the Commune Council's discretionary budget, known as the Commune Sangkat Fund (CSF), tied to a local development planning process and budgeting regulations that reflect procedures introduced and refined under the CDCs.
- *Politics of resource allocation.* Although broad and imprecise (see below), the 2001 LAMC assigned to CCs a broad mandate and powers in relation to this mandate. As importantly, these laws expressed the fundamental principle that resources must be made available to CCs commensurate with their mandate. This effectively shifted the focus of local governance from an administrative process of 'planning' toward an essentially political process of contest around the 'budget' and a concept of entitlement.
- *Social acceptance.* The relatively smooth electoral process and qualitative research seems to indicate that people believe that CCs have become embedded as a permanent feature of Cambodian governance (Kim and Ojendal 2007). While there are clearly limits to what CCs are able to do (see below), it is nonetheless true that these institutions are in most places at most times seen to be an improvement upon the unelected Commune authorities that preceded them.

While the 2001 legislation has helped consolidate and formalize institutional arrangements conducive to political equity that were originally introduced through Seila project law, such legislation cannot on its own be expected to ensure this embedding occurs. For each of the above indications, there remain strong countervailing pressures that weaken their effect. Thus, the operations of key line departments (e.g., health or forestry) are not aligned with the territorial authority of the CCs; and the C/SCs still have little or no mandate to manage local natural resources and in the process raise revenue). While most donors and NGOs recognize the authority of the CC, most planning and funding decisions run in parallel with the CC's procedures. Finally, public acceptance of CCs is qualified by a common perception that they are seldom able to respond to local demands (especially for the resolution of local disputes) and not themselves immune from corruption.

The situation with regard to the DIW is clearly different, but perhaps not fundamentally so: the constraints on the DIW are connected to those that threaten the durability of CCs. The DIW remains an artifact of project law (although correspondingly supported by sub-decrees and regulations): the consolidation achieved when CDCs were reformulated into the CC structure has not occurred with respect to the DIW. However, the Strategic Framework for Decentralization and Deconcentration Reforms (D&D Framework) approved in June 2005 reiterates a political commitment to local representative democracy as the primary way of making the state accountable to Cambodian citizens: it also commits the Government to creating durable institutional arrangements that encapsulate the strategic principles reflected in the DIW. These include a 'two way' accountability process between CCs and District/Province administrations, in which local and national priorities are to be reconciled; and the subsidiarity principle that a 'unified' local administration will be needed for this purpose.

How the government intends to achieve this is far from clear. But from international experience, institutional arrangements of the sort promoted by the DIW—that is, multi-level planning and budgeting, supporting a process of political negotiation, administrative

performance and public scrutiny—will need to be created. In light of the ‘demonstration effect’ of the CDC, it is plausible that the administrative familiarity with the DIW may result in its incorporation in subsequent mainstream regulations. On the other hand, there is a frustration with the DIW process. Despite the fact that it facilitates around 40,000 agreements each year, it has proven largely ineffective in extending its remit beyond Seila-funded activities: in particular, it has yet to influence how Province line departments and other significant non-Seila mechanisms for planning and resource allocation operate (Independent Study 2006; GTZ 2005).

Interim institutional solutions and “good contests”

The cases of labor law and local governance above suggest that technical short-cuts, using aid as an incentive to reform, often have limited long-term effect, precisely because the effectiveness of formal institutions depends critically on the degree to which they are embedded in informal institutions (values, expectations, negotiating styles, ability to draw on support in other groups in society, and so on). An implication of this is that stronger, more sustainable reforms depend heavily upon the degree to which they are perceived as legitimate in local context. This legitimacy in turn depends heavily upon the processes by which change is achieved, rather than simply the form of the arrangements that are achieved. To a great extent, what then matters is that there are fair rules and appropriate forums in which debate between contesting parties can occur and new organizational arrangements can emerge.

A number of the other cases of equity-enhancing policies cited elsewhere in this report reinforce these conclusions. The evolution of the systematic land titling program, for example, can be considered a good example of significant improvement through a cautious, evolutionary approach to the improvement of regulatory institutions. And in those MOPS case study villages where testimony suggests domestic violence is beginning to decline, it is because the law on the book is reinforced by local actors disseminating information, facilitating discussion and connecting citizens to institutional actors (notably NGOs) that can support their case. In this case, too, the outcomes are short of the ideal: abusive husbands are jailed locally for a matter of days as a warning, without cases proceeding to court and the far heavier sentences that application of the statute law would mandate. Nonetheless, it *is* progress: wives, neighbors, police and local authorities no longer regard domestic violence as a purely private issue; victims now know where to seek solidarity and material support; abusers now expect punishment; and outcomes, in terms of the incidence of violence as reported in focus group discussions, appear to have improved markedly. The current situation—in which existence of legal principles, backed up by changing social values fostered by civil society organizations, leads to partial application of those legal principles—can be seen as an interim step on a road to the ultimate goal (strict application of the law by state institutions of justice).

The roles of civil society and external development partners

Organized civil society has a potentially valuable role to play in promoting the ideal of equity in Cambodia’s national development process. Community organizations and NGOs can help poor and marginalized groups in society to achieve a collective voice in

the policy process, channeling concerns to policy-makers at both local and national levels. Together with an independent press, these organizations help improve communication from the grassroots to senior policy-makers, helping officials to identify when problems are occurring and what solutions might be most likely to succeed. Civil society also plays a key role in establishing a culture of transparency and accountability. Institutional arrangements that create a space for citizens, individually or collectively, to feed back to the upper level of Government can help to identify both when more commitment is needed, and when policies are failing in implementation due to corruption or capacity bottlenecks.

For their part, Cambodia's official development partners need to ensure that they effectively support Government commitments to equitable development. To do this, they need to fulfill their commitments under international and national agreements on ownership, harmonization and alignment, moving away from donor-driven models of aid (that is, models characterized by tied spending, projects and externally-determined technical assistance), and towards genuine partnerships around collectively-agreed development goals.