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**CAMBODIA AT THE CROSSROADS**  
**Strengthening Accountability to Reduce Poverty**

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## Abbreviations and Acronyms

<b>ADD:</b>	<i>Accelerated District Development.</i>	<b>NGO:</b>	<i>Non-Governmental Organization.</i>
<b>ADESS:</b>	<i>Agricultural Development Support to Seila.</i>	<b>NPRS:</b>	<i>National Poverty Reduction Strategy.</i>
<b>ADHOC:</b>	<i>Cambodian Human Rights and Development Association.</i>	<b>NPV:</b>	<i>Net Present Value.</i>
<b>APR:</b>	<i>Annual Progress Report.</i>	<b>NT:</b>	<i>National Treasury.</i>
<b>ASEAN:</b>	<i>The Association of Southeast Asian Nations.</i>	<b>ODA:</b>	<i>Official Development Assistance.</i>
<b>ATC:</b>	<i>Agreement on Textiles and Clothing.</i>	<b>OECD:</b>	<i>Organization for Economic Co-operation and Development.</i>
<b>BMOs:</b>	<i>Business Membership Organizations.</i>	<b>PAP:</b>	<i>Priority Action Program.</i>
<b>BOT:</b>	<i>Build-Operate-Transfer.</i>	<b>PBC:</b>	<i>Planning and Budgeting Committee.</i>
<b>C/SC:</b>	<i>Commune/Sangkat Council.</i>	<b>PCB:</b>	<i>Permanent Coordinating Body of the Council for Legal and Judicial Reform.</i>
<b>C/SF:</b>	<i>Commune/Sangkat Fund.</i>	<b>PDRD:</b>	<i>Provincial Departments of Rural Development.</i>
<b>C/SF Board:</b>	<i>Commune/Sangkat Fund Board.</i>	<b>PIF:</b>	<i>Provincial Investment Fund.</i>
<b>CAR:</b>	<i>Council for Administrative Reform.</i>	<b>PIP:</b>	<i>Public Investment Program.</i>
<b>CDC:</b>	<i>Council for the Development of Cambodia.</i>	<b>PIUs:</b>	<i>Project Implementation Units.</i>
<b>CDRI:</b>	<i>Cambodia Development Resource Institute.</i>	<b>PFM:</b>	<i>Public Financial Management.</i>
<b>COM:</b>	<i>Council Of Ministers.</i>	<b>PLUAC:</b>	<i>Provincial Land Use and Allocation Committee.</i>
<b>CPIA:</b>	<i>Country Policy and Institutional Assessment.</i>	<b>PLUP:</b>	<i>Participatory Land Use Planning.</i>
<b>DDC:</b>	<i>District Development Committees.</i>	<b>PMATU:</b>	<i>Poverty Monitoring and Analysis Technical Unit.</i>
<b>DFW:</b>	<i>The Department of Forestry and Wildlife.</i>	<b>PPEM:</b>	<i>Participatory Public Expenditure Management.</i>
<b>DISHA:</b>	<i>Development Initiatives for Social and Human Action.</i>	<b>PPI:</b>	<i>Private Provision of Infrastructure.</i>
<b>FBC:</b>	<i>The National Assembly's Finance and Banking Committee.</i>	<b>PT:</b>	<i>Provincial Treasury.</i>
<b>HIPC:</b>	<i>Highly Indebted Poor Country.</i>	<b>RS:</b>	<i>Rectangular Strategy.</i>
<b>HRMIS:</b>	<i>CAR's database.</i>	<b>SARS:</b>	<i>Severe Acute Respiratory Syndrome.</i>
<b>IFAPER:</b>	<i>Integrated Fiduciary Assessment and Public Expenditure Review.</i>	<b>SCM:</b>	<i>Supreme Council of the Magistracy.</i>
<b>MDGs:</b>	<i>Millennium Development Goal.</i>	<b>SEDPII:</b>	<i>The Second Socio-Economic Development Plan.</i>
<b>MEF:</b>	<i>Ministry of Economy and Finance.</i>	<b>SFMPs:</b>	<i>Strategic Forest Management Plans.</i>
<b>MFA:</b>	<i>Multi Fiber Agreement.</i>	<b>SWIM:</b>	<i>Sector-Wide Management.</i>
<b>MFU:</b>	<i>Municipal Forest Unit.</i>	<b>TA:</b>	<i>Technical Assistance.</i>
<b>MoE:</b>	<i>Ministry of Environment.</i>	<b>TWGs:</b>	<i>Technical Working Groups.</i>
<b>MOE:</b>	<i>Ministry of Education.</i>	<b>VAT:</b>	<i>Value Added Tax.</i>
<b>MOH:</b>	<i>Ministry of Health.</i>	<b>VDCs:</b>	<i>Village Development Committees</i>
<b>MOI:</b>	<i>Ministry of Interior.</i>		
<b>MPTC:</b>	<i>Ministry of Post and Telecommunications.</i>		
<b>NAA:</b>	<i>The National Audit Authority.</i>		
<b>NCSC:</b>	<i>The National Committee to Support the Communes/Sangkats.</i>		



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## ABSTRACT

1. The Government of Cambodia has just adopted the Rectangular Strategy for Growth, Employment, Equity and Efficiency in Cambodia. This Strategy rightly describes governance as the “most important pre-condition to economic development” in Cambodia. The agenda for the up-coming Consultative Group Meeting on December 6-7, 2004 is designed around the Rectangular Strategy and the discussions at the CG Meeting will focus on the critical policies and investment that are needed to attain the vision for a more prosperous and better governed Cambodia that is laid out in this Strategy.

2. This Brief for the CG Meeting focuses on the key governance challenges facing Cambodia and aims to provide an analytical foundation for facilitating the debates and discussions on these issues at the upcoming CG Meeting. The Report *Cambodia at the Crossroads* argues that it will take more than the policies set out in the Rectangular Strategy to transform governance in Cambodia so that it is supportive of and not destructive to the development process. What is needed is a concerted effort to strengthen, and in many cases to build from scratch, the foundations of a modern chain of accountability. Such a reform effort will necessarily take a long time to implement, far longer than the life of Cambodia’s third Parliament. But if the current trends in governance can be reversed, and if the foundations are laid in a few key areas for enhancing accountability, a good beginning will have been made and strong signals sent to all players in the economy that the rules of the game are changing.

3. The Report includes an Overview followed by six chapters. The Overview provides a brief account of recent progress in Cambodia’s development efforts. It then sets out to describe Cambodia’s system of public accountability and analyzes why it breaks down at such cost to its poor and vulnerable. It provides a framework for examining how citizens can hold service providers accountable for better service delivery, both through the long route of accountability via politicians that they have elected who in turn hold the service providers accountable, and through the short route of accountability where they organize themselves to demand better services from civil servants and other service providers. It examines the role of various institutions such as the National Assembly, the judiciary, the press, NGOs and other civil society organizations in strengthening these chains of accountability.

4. The rest of the Report is organized as follows. Chapter 1 provides an IMF staff assessment of Cambodia’s recent economic performance and medium-term prospects drawing on the IMF’s recent Article IV Consultations. Chapter 2 examines why Cambodia’s poor do not benefit from public spending. It commends the Government for designing a comprehensive public financial management reform program to address this challenge and stresses the need for speedy implementation of the agreed reform program. Chapter 3 argues that deconcentration and decentralization can improve the

lives of ordinary citizens if focused on better service delivery by increasing participation, amplifying voice and enhancing transparency, and shortening the chain of accountability from local communities to their government. It argues that while some progress has been made on decentralization, deconcentration of state functions has made very little progress. A vision for the next steps for both decentralization and deconcentration is currently being developed. Chapter 4 tackles the tough subject of natural resources management and argues that despite the abundant natural resource endowments of Cambodia, these resources are not being used for the benefits of Cambodia's citizens, especially its poor. A more inclusive, transparent and accountable system of natural resource management is urgently needed in Cambodia. Chapter 5 describes the challenges of governance facing the private sector in Cambodia. It argues that urgent action is needed to reduce the costs of business so that the 6-7% growth that is needed for job creation and poverty reduction can be maintained in the medium-term once the garment quotas are removed at the end of 2004. Finally, Chapter 6 focuses on governance issues surrounding the effectiveness and management of aid provided to Cambodia. It argues that while there has been some improvement in 2004, donor practices in Cambodia still have considerable scope for improvement if donors are to become part of the solution rather than part of the problem in Cambodia. In particular, levels and composition of aid need to be better related both to Government priorities but also to Government performance.

## **Cambodia: At The Crossroads Overview**

*“Good governance is the most important pre-condition to economic development with sustainability, equity and social justice. Good governance requires wide participation, enhanced sharing of information, accountability, transparency, equality, inclusiveness and the rule of law. Good governance requires that corruption be reduced to the minimum, the views of minorities and the voices of the most vulnerable in society be fully heard and considered in decision-making processes.”*

*-The Rectangular Strategy 2004-The Royal Government of Cambodia.<sup>1</sup>*

1. The Consultative Group for Cambodia meets at a critical juncture in the nation’s history. A new government has taken charge following a prolonged hiatus after the July 2003 elections. The delay has proved costly in terms of the lost momentum to much needed reforms. But the process has nevertheless resulted in the emergence of a Rectangular Strategy (RS) reflecting agreement between the coalition partners and is characterized as the new Government’s “action plan for the next four years”.<sup>2</sup> The new strategy has four key goals: economic growth, employment generation, improved governance and accelerated implementation of reforms in all sectors to “reduce poverty and achieve sustainable development.” Good governance is seen as the heart of the strategy.
2. The Rectangular Strategy must be welcomed as an early sign that the new government is committed to a process of reforms. Such reforms could within the space of a generation transform the prospects for two-thirds of Cambodia’s population that lives on less than \$2 a day. The substantial additional wealth creation will also help meet the rising expectations of a population that increasingly demands more than just the physical security that peace has bought. The Strategy is also entirely right in describing governance as the “most important pre-condition to economic development” and it is indeed encouraging that the government sees this as the core of its strategy. That is why this Brief for the Consultative Group focuses on the key governance challenges facing Cambodia.
3. It will however, take more than the policies set out in the Rectangular Strategy to transform governance in Cambodia so that it is supportive of and not destructive to, the development process. What is needed is a concerted effort to strengthen, and in many cases to build from scratch, the foundations of a modern chain of accountability. Such a reform effort will necessarily take a long time to implement, far longer than the life of Cambodia’s third Parliament. But if the current trends in governance can be reversed, and if the foundations are laid in a few key areas for enhancing accountability,

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a good beginning will have been made and strong signals sent to all players in the economy that the rules of the game are changing.

4. This chapter provides a brief overview of recent progress in Cambodia's development efforts. It then sets out to describe Cambodia's system of public accountability and analyzes why it breaks down at such cost to its poor and vulnerable. It concludes with an overview of five key reform areas that would make a substantial impact on growth and poverty. Moving decisively on a governance agenda that is firmly grounded in a broader poverty reduction strategy, it is argued, will potentially create a strong positive momentum for poverty reduction.

### **A. Background**

#### ***Cambodia has made impressive gains, but faces serious challenges***

5. Cambodia's post-conflict record is a mixed one. On the one hand, there has been some remarkable progress in a number of dimensions. Three peaceful and apparently fair elections have been held. Peace and stability and a precious sense of normality have been restored. The institutions of government have resumed functioning. Democratic institutions are emerging. The web of civil society is spreading, and an undeveloped media is beginning to exercise its newly won freedoms. With the recent commune-sangkat elections, a tentative but impressive effort to spread democracy to local governments has begun.

6. On the economic side, the country has until recently enjoyed strong, if imbalanced growth. Preferential access to the US garments market, has led to a substantial increase in Cambodia's exports. The boom in garments exports, the revival of tourism, the substantial aid Cambodia has received, and the recovery from conflict have contributed to a 6.7% per annum average growth rate between 1994 and 2002. Macro-economic stability has been maintained through fiscal discipline and a modest but improving revenue effort. On the external front, Cambodia's recent entry into the World Trade Organization (WTO) is yet another sign of the country's return to the world stage. Structural reforms in the early years of the last government have contributed significantly to this relatively strong performance.

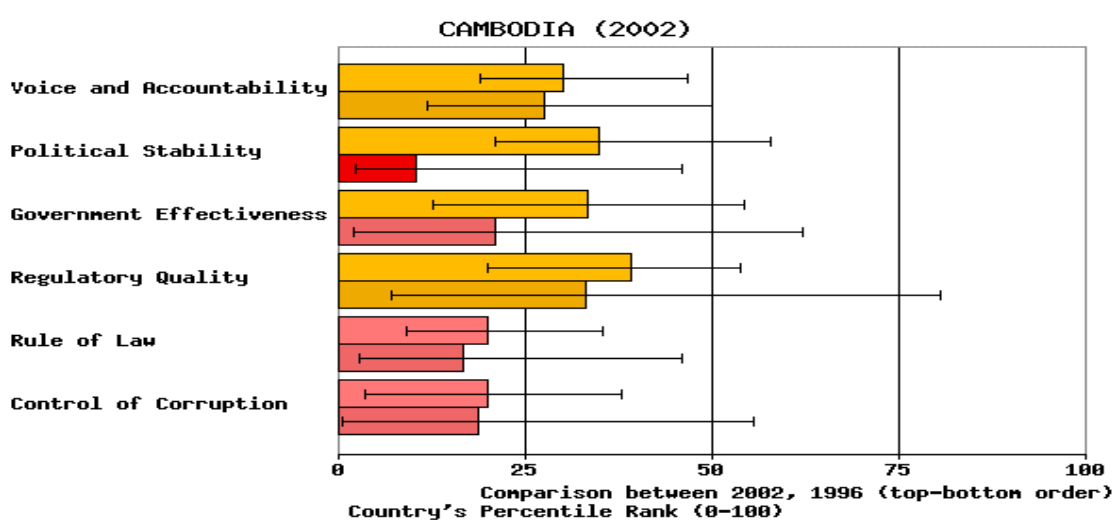
7. These favorable developments mask three serious challenges the new government faces. First, growth is seriously threatened in the short to medium term. The IMF estimates that growth could fall precipitously in 2005 to 2% recovering gradually to 6-6.5% only by 2009 and only then provided the government presses ahead with reforms that improve competitiveness and the climate for investment. The deceleration in growth reflects slow progress on structural reforms in recent years, and the elimination of the quota system under the Multi Fiber Agreement at the end of 2004, which will expose Cambodian exporters to severe competition from more competitive

producers. There is thus an urgent need to accelerate governance and structural reforms.

8. Second, income poverty levels are high (around 40%) and stagnant. The labor market is also failing to absorb most of the 200,000 new entrants annually entering the labor force. For non-income poverty, the story is mixed. Cambodia appears to be off track to meet most of the Millennium Development Goals. Food security is lagging: at 36%, the proportion of people suffering from hunger is far from the 2015 target of 19.5%. Child mortality has increased over the past 10 years particularly post-neonatal mortality. The main causes have been diarrhea, acute respiratory infections, and vaccine preventable diseases, particularly measles where the coverage rate of immunization is only 59%, well-below the 2015 target of 90%. Despite progress, the maternal mortality rate (MMR) remains extremely high at around 437 per 100,000 live births. Health and sanitary conditions are very poor: only 30% of the population has access to safe drinking water and only 17% has access to sanitation facilities. Cambodia could achieve primary education for all by 2015, but is unlikely to reach its secondary education and gender equality targets.<sup>3</sup>

9. Third, governance as the government recognizes, remains a serious challenge. Perception based data (Figure 1) show some improvement in all governance indicators between 1996 and 2002, although the margins of error are too high to allow confidence about the direction of change. In two areas, though, control of corruption and the rule of law, Cambodia ranks among the bottom quartile of performers among all countries. Domestic surveys confirm that corruption is endemic and high.

Figure 1: Cambodia's Governance Indicators 2002 and 1996.



Source: D. Kaufmann, A. Kraay and M. Mastruzzi, 2003: Governance Matters III: Governance Indicators for 1996-2002 (<http://www.worldbank.org/wbi/governance/pubs/govmatters3.html>)

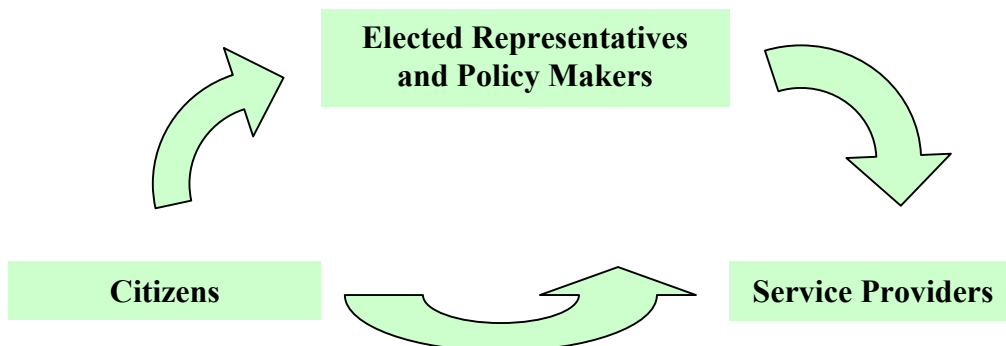
10. That corruption is not just a matter of perception is confirmed by a recent World Bank Investment Climate Assessment (World Bank, Cambodia: Seizing the Global

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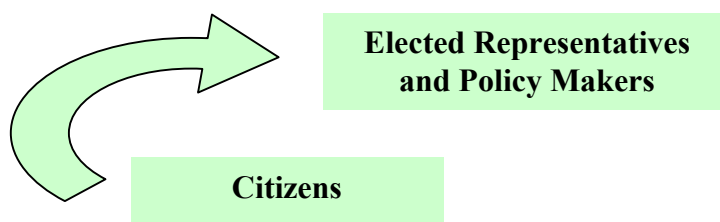
Opportunity, 2004) where firms reported that payments to public officials are frequently, mostly, or always required. Of the 447 firms that answered the question on bribe payments, 82% (368) reported a positive level of bribe payments. The share of revenues consumed by such payments averaged 5%, more than double those found in parallel surveys in Bangladesh, Pakistan and China. Firms also reported that an average of 5% of the contract value was required to secure business with public agencies. Firms also perceived influence to be concentrated among certain privileged groups which dominate key sectors and have ties to political leaders, exercising substantial influence over national laws and regulations.

11. Weak governance and the failure to control corruption and enforce the rule of law underscore the country's limited institutional capacity, the lack of trust among the elite and strong resistance to reforms from powerful vested interests. These are the dark clouds from Cambodia's tragic past that have cast a shadow over what could be a bright future and that prevent the relatively young and weak institutions of restraint from working effectively to ensure accountability and transparency. How and why accountability breaks down is discussed next.

### **B. Cambodia's Governance and Accountability Framework**



12. The Rectangular Strategy is unequivocal in committing the Royal Government of Cambodia to establishing a liberal democracy with respect for human rights, as enshrined in the country's sixth Constitution adopted in 1993 and amended in 1999. Like other democracies, Cambodia's framework of accountability, derived from the Constitution, is based on three key relationships of accountability: between citizens and the State; between the elected officials of the state and those responsible for delivering the essential services the state provides citizens; and between those who deliver services and the citizens who receive and consume these services.

**Citizens and Elected Representatives/Policy Makers**

13. The principle of the separation of powers and the need for executive power to be subject to legal restraints is established in the Cambodian Constitution. The principal instruments for such checks and balances are the National Assembly and the judiciary. Moreover, Government ministers and officials are individually and collectively accountable to the National Assembly for overall policy and individual conduct, as provided in Article 121 of the Constitution. Yet in the face of a powerful executive which tends to monopolize the policy making processes, both the legislative and judicial branches of government face severe challenges in performing their constitutional role.

14. Given that Cambodia's democracy is rather young, it is not surprising that Members of the National Assembly face difficulties asserting their role vis-à-vis the Executive. Key constraints facing the National Assembly are little experience in drafting legislation or debating policies, late involvement of legislators in the analysis and review of proposed legislation, limitations imposed by political realities on the exercise of the National Assembly's scrutiny and oversight functions and little knowledge and exposure to key development problems. The Secretariat to the National Assembly has limited resources and capabilities at its disposal. This contributes to poor services for parliamentary committees and individual members and lack of coordination between the House and the Senate. Moreover, loyalty to party appears to override loyalty to the constituencies that members of the National Assembly represent. Nor does the political platform of the Royal Government specifically discuss the role of the National Assembly in the oversight of the government's economic programs and policies and of the national budget, though it does commit the Prime Minister and members of the Royal Government to "converse actively" with the National Assembly (Point #7).

15. The judiciary, the second principal source of restraint on the power of the executive, was decimated under the Khmer Rouge.<sup>4</sup> The country's judges either fled the country or were killed. From a legal profession of some 400-600 people prior to 1975, some 10 remained in the country five years later. The 1980s saw an effort to rebuild the judicial system, drawing on teachers and others to fill the posts of judges and prosecutors (Evan Gottesmann, 2002). But till today it remains largely devoid of legal talent. Only one in six of Cambodia's 117 judges has a law degree, and only one of the nine Supreme Court judges. Only 10% of public prosecutors has a law degree. Thus the judiciary inherited by democratic Cambodia is ill-equipped to do its job, conditioned to being subservient to the executive branch, poorly paid and allegedly corrupt. The

## *Cambodia At The Crossroads*

Supreme Council of Magistracy, a constitutional device aimed at ensuring the judiciary's independence and competence, is in urgent need of reform. The other components of the justice sector such as the police are also dysfunctional. What it would take to reform the judiciary, an issue that is high on the list of priorities of the Rectangular Strategy, is discussed later in this chapter.

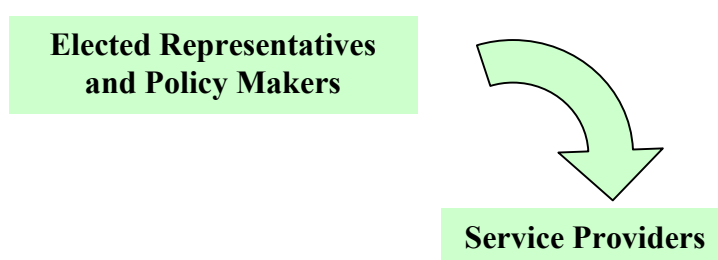
16. With parliament and the judiciary weak, Cambodians must rely on an underdeveloped media and civil society to amplify their voice and hold the executive accountable. A Law on Press Regime, enacted in 1995 guarantees press freedom, prohibits censorship, and guarantees the right to protect the confidentiality of sources. No prior licensing is required to publish a newspaper. The law however does restrict publication of reports that harm "national security or political stability" or "humiliate national organs". And journalists are vulnerable to legal prosecution for defamation or disinformation. This exposes the press to the risk of interventions by the government and opens the door to self censorship. Nevertheless the 10 or so newspapers that publish regularly appear to be relatively free. There is as yet no equivalent law for the broadcast media, which with 20 radio and 7 TV channels reaches far more people. Radio is particularly popular and an avenue for free speech. At the same time the press itself needs to be more responsible in terms of the accuracy and objectivity of its reporting. The media would therefore benefit from training in responsible investigative journalism, and self policing by media bodies may also be needed along the lines of a Press Council in other countries.

17. Civil society is growing rapidly, but it is far from effective in amplifying the voice of citizens and in particular the poor. Most indigenous NGOs are relatively young, inexperienced, and constrained by the familiar problems of collective action. There is little tradition of consulting NGOs prior to enacting an important law or developing a new policy, unless there is donor pressure for such consultations. Local NGOs rely on international ones to raise issues with government through their influence with bilateral donors. Heavy dependence on foreign funding tends to shift NGO accountability from the poor in Cambodia to foreign fund providers. The NGOs also need to practice what they preach by being responsible and ensuring that their management and finances are subject to the same degree of transparency and accountability that they demand of government. A law governing the operation of NGOs, proposed in the Rectangular Strategy, could potentially help ensure adequate accountability and transparency within the NGO sector. But such a law will need to satisfy domestic and international NGOs that it would safeguard NGO independence and would not be used by a government that resents their criticism of its policies to restrict their activities.

18. Most Cambodians today enjoy an unprecedented freedom to express their opinions. Civil protests are now common on a range of issues such as wages, corruption and electoral laws. Strikes have become more common as tolerance for poor management practices decreases and workers organize for collective action. These are

healthy trends although still rather tentative. Freedom of speech and dissent is not yet seen as a right but as something that is tolerated, with lack of clarity on the limits of such tolerance. Yet these new freedoms are an essential safety valve that create space for a healthier relationship between government and civil society and need to be encouraged. International experience shows that a free press, a vigorous civil society and a citizenry that is willing to hold its government accountable produces greater public accountability and improved public services. Recognition of this in the Rectangular Strategy can be seen in the invitation to civil society to be the government’s partner in development and in the commitment to encourage the activities of NGOs.

***Elected representatives/policy makers and service providers***



19. In all governments, politicians are the primary policy makers, but to perform the main functions of the state, implement policies and deliver services they must delegate these functions to bureaucrats. This gives rise to what economists call the *principal-agent problem*<sup>5</sup>, the challenge of ensuring that the agents, the service providers to whom these functions are delegated actually undertake their responsibilities in the most economic and efficient manner. The *principal* must establish the rules which guide the bureaucracy through laws and regulations. They must then develop formal or informal “compacts” with the bureaucrats. In exchange for a given set of incentives, (salaries, allowances and other benefits) the bureaucrats are held accountable for undertaking tasks assigned to them. Accountability is enforced through a variety of means: internal checks and balances, (internal audits, ex-post program evaluation and reporting), formal channels for review of administrative decisions that affect the rights of individuals, and external restraints (the supreme audit agency, the proposed anti-corruption commission, freedom of information legislation and laws requiring disclosure of assets), and disciplinary action. Systems of accountability depend on the generation of adequate information on performance. When the compact breaks down, it typically results in corruption and poor service delivery. Corruption can either be administrative in nature, where civil servants derive rents during the implementation of policies, or it can involve the capture of the state by vested interests to influence laws, regulations and policies to their advantage. State capture usually involves corruption of the *principal*, i.e., the politicians, but it also usually requires collusion between the politicians and the bureaucrats who must help implement the corrupt policies or programs.

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20. In Cambodia, as we have seen above, corruption is endemic, reflecting a breakdown of the system of accountability. The compact between elected representatives/policy makers and service providers breaks down in several ways. First, the compact between politicians and civil servants is weakened by an inadequate legal framework that guides the behavior of civil servants and by the failures of enforcement. There is no modern civil, criminal, and commercial procedural code, nor an Anti-Corruption Law, though these are all being developed. Law enforcement officials and the courts, however, do not enforce the laws that do exist. Second, the state fails to ensure that civil servants have the capacity or the incentives to deliver the tasks assigned to them. Capacity is weak both in terms of skills and the resources to do the job. With the wholesale decimation of Cambodia's educated elite under the Khmer Rouge, the country has but a thin crust of well qualified and experienced public officials.

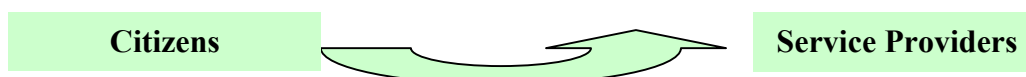
21. Incentives for civil servants are also perverse. Civil servants are poorly managed and underpaid, thus undermining their incentive to honor their side of the compact. Civil service salaries are ridiculously low. Category A employees with some 4 years of post secondary school education earn a paltry \$40 a month. The average civil service wage is only slightly more than the country's per capita GDP, one of the lowest in the region. The ratio of average pay of the highest to that of the lowest category is less than 2. Expenditure on direct service provision and maintenance is also pitifully inadequate.

22. Cambodia's low revenue effort, which offers opportunities for substantial improvement, contributes to this vicious cycle of corruption. Revenues are low in part because revenue collection is vulnerable to corruption. Lack of transparency in the private provision of infrastructure and land and other state property concessions reduces the amount of revenue that should be accruing to the Treasury. Low revenues in turn mean low wages and low service provision spending, which contributes to corruption. Cambodia's civil service needs to transition from the current patronage and network based system (Gottesman, 2002) in which powerful patrons manage their networks of loyal civil servants in a mutually dependent relationship to one that is merit based and professionally managed. The Rectangular Strategy commits the government to such a reform.

23. On the other hand, the systems of accountability are too weak to allow policy makers to check corruption even if they wanted to do so. Cash-based payment systems not only result in unpredictability in the release of budgetary allocations due to cash shortages, but when combined with deficient accounting and reporting systems, lead to a weak control environment and increasing opportunities for corruption. The institutions that exist to check such corruption, Parliamentary oversight and systems of internal controls of cash and financial management, do not function effectively. The systems of external accountability are underdeveloped. The national audit function is relatively new and the long proposed anti-corruption commission is yet to be established. Even without the severe capacity constraints that affect all institutions,

these agencies for external accountability are only likely to work in a political environment that respects their autonomy and is supportive of their functions.

### *Citizens and service providers*



24. Cambodians deal with civil servants as service providers far more often than they deal with their elected representatives. From enrolling their children in school to attending a primary health care center, to obtaining a driving license or encountering the police, Cambodians see the public face of service delivery every day of their lives. Yet, while citizens should be able to directly hold officials accountable to them for the quality and efficiency of services they deliver, they have little authority or control over such officials. The culture of the bureaucracy is yet to become one where the bureaucrats see citizens as their masters and themselves as servants of the people. Further, a culture of transparency is needed among Cambodia's civil servants where information held by them should be easily available to the public unless there is some overriding public interest stipulated in law that justifies secrecy.

25. In more mature democracies, citizens can enhance their leverage over the bureaucracy by organizing themselves through parents associations, religious organizations, or NGOs for instance. These are means of exerting pressure on the bureaucracy by enhancing voice and increasing the flow of information on the quality and efficiency of services they receive. In Cambodia, as we have seen above, NGOs are still relatively inexperienced and weak. The cost of organizing to protect common interests can be high. In a hierarchical society, efforts to organize can be viewed with suspicion and the poor may be afraid to speak out for fear of retribution. And information needed to monitor public officials is lacking. But if the government is serious about its commitment to work with civil society as a partner, it needs to encourage NGOs to organize communities and the poor, as well as monitor the performance of bureaucrats and service deliverers. There is considerable scope for a more systematic dialogue between citizens and service providers, facilitated by NGOs, which increases the latter's service orientation. Access to information held by public authorities must be seen as the basis for citizens to participate effectively in formulating and implementing government policy and for informed public debate about the actions of government. A Freedom of Information Law could help bring about such a shift in culture.

### *Poverty and governance*

26. The failures of accountability and transparency noted above, and the slow progress towards the rule of law represents a serious failure of governance for which Cambodia's poor pay a heavy price. The poor suffer the most from physical insecurity

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and lack of access to justice. Poor governance weakens the ability of the state to deliver basic public goods: essential services that are crucial to the investments needed in the human capital of the poor. The poor are particularly helpless in the face of corruption. They depend disproportionately on public goods and are often unaware of what they are required to pay for public services, allowing the corrupt to trade on their ignorance. Poor governance also leads to inequality in land holdings which weaken future economic growth. It contributes to deforestation and misuse of the country's natural resources. But above all, corruption, inefficiency and the inability to enforce contracts and property rights combine insidiously to impose a high cost on domestic and foreign investors. Furthermore, this burden is also experienced by ordinary Cambodians who wish to make a living from agriculture, fisheries or trading. As a result private investment is deterred and economic growth is lower than it should be. With the impending decline in garments exports noted above, unless the government urgently addresses these governance issues, growth will decline and with it the ability of the country to reduce poverty significantly. Thus, though there are other factors that impact poverty, the government recognizes in the Rectangular Strategy that improved governance lies at the heart of the poverty reduction agenda.

### **C. Reform Priorities**

27. The failure of accountability and governance described above is not untypical of countries undergoing simultaneous and complex transitions. Cambodia is transitioning:

- From a highly centralized and hierarchical governance, necessitated by the need to restore order and stability following years of conflict, to one where power is decentralized both vertically and horizontally;
- From a society dominated by networks and informal rules, to a society that is based principally on formal rules;
- From a state dominated but predominantly peasant based agricultural economy to a diversified market-based economy.

28. Such transitions are highly demanding on the political leadership of a country, because they require taking on powerful vested interests that are closely integrated in the country's power structure, and drastically changing the rules and incentives by which the country has been operating. Transition is further complicated by a weak and underpaid bureaucracy and fragile and corrupt institutions that reflect Cambodia's low income and least developed country status. On the other hand, the leadership has little choice. A continuation of the present state of affairs is not an alternative, since this at best will result in a deepening of poverty, and at worst could mean a slide back into an authoritarian and conflict-prone state.

29. Given the difficult reform environment, it is important that the government is highly selective and strategic; focusing on those areas where poor governance is

seriously impeding the country's development prospects. This report looks at a few such areas. Strengthening the chain of accountability in Cambodia will require strengthening checks and balances, in particular through a competent, honest, and independent judiciary. Judicial reform is also needed to restore investor confidence by enforcement of property rights and contracts. Urgent action is also needed to stop the plunder of the nation's financial and natural resources. This will require strengthening financial accountability and enhancing accountability and transparency in natural resource management, and through decentralization, bringing government closer to the people so they can better monitor its performance. Finally, a high priority is removing governance impediments to private sector growth and competitiveness, and hence to the diversification that is urgently needed in light of the threat to the country's garment exports. These areas of governance are firmly embedded in the Rectangular Strategy. In the case of public financial accountability, the government has already begun to implement a public financial management program. For the private sector, the government has developed an action plan to reduce the cost of doing business in Cambodia. Likewise, the Government has already done a great deal of homework on judicial reform and prepared short and medium term action plans. Similar strategy development processes are now beginning in the areas of decentralization and natural resource management.

30. The choice of these five areas is not intended to suggest that other governance areas are of less important. There are issues, such as the strengthening of the National Assembly or civil society that lie beyond the Bank's area of expertise, which are clearly important. Nor does this report suggest that governance is the only development challenge in Cambodia. But as is clear from the analysis above, it is increasingly an important precondition to growth and sustainable poverty reduction. Indeed the growing threat to Cambodia's growth prospects in the short to medium term arising from the projected deceleration of garment exports, which has driven much of the country's recent economic growth, and the close link between governance factors and the weak investment climate suggests that governance reforms must of necessity be high on the government's agenda.

#### **D. Strengthening Checks and Balances through Reform of the Justice Sector**

31. As noted above, an ineffective National Assembly and a malfunctioning justice sector undermine the separation of powers between the three branches of government that was clearly intended in Cambodia's Constitution. This section focuses on reform of the justice sector which is central to ensuring the accountability of the executive branch as well as enforcing the laws of the country, enforcing contracts and settling disputes. A comprehensive legal and judicial reform strategy was endorsed by the Council of Ministers in June 2003. Following this endorsement, the Royal Government, under the leadership of the Permanent Coordinating Body (PCB) of the Council for Legal and Judicial Reform undertook broad consultations with government agencies, civil society

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and donors. From this has emerged a short term (2004-2006) and medium term (2004-2008) plan of action. These plans are ambitious. But they represent a significant advance in the government's thinking in this area. The new government now needs to move decisively to begin the process of reform, devoting adequate financial and human resources to the task and demonstrating real progress in a few strategic areas. In particular:

32. ***Strong leadership is needed of the reform process.*** The legal and judicial reform effort needs to be entrusted to an inter-ministerial body on which the key agencies are represented, and led by genuine and dynamic reformers who enjoy credibility with both the legal profession and the general public, and strong political support at the highest level. This body must be empowered to rationalize the somewhat confusing and overlapping responsibilities of the key sectoral agencies, such as the Ministry of Justice, the Supreme Council of Magistracy (SCM), the Council on Legal and Judicial Reform and the Supreme Court in regard to the administration and regulation of justice, resolution of complaints, judicial inspections and disciplinary sanctions, and identify *all* players who will be involved in the process and their specific accountabilities. This body needs to take the current draft action plan and to prioritize it and focus on a few key strategic actions.<sup>6</sup> Such a plan needs to be adequately funded and free from the uncertainties that mark the Cambodian budget process.

33. ***Reform must begin with the SCM.*** The SCM's current membership<sup>7</sup> (apart from the now retired King who chaired it but rarely attended meetings) is affiliated to one or other of the ruling political parties. The government needs to consider instead appointing men and women of outstanding integrity and capability with no party affiliation or potential conflicts of interest. The appointment process needs to be seen to be objective and independent of executive influence, and there are a variety of international models that could be explored. A reformed SCM should be adequately funded and supported by the Ministry of Justice to fulfill its responsibility for oversight of draft laws pertaining to the judiciary and for decisions relating to judicial appointments, transfers, promotions and disciplinary actions.

34. ***The reformed SCM must begin by overhauling the high courts.*** It will take time to professionalize Cambodia's courts. But reform must begin with the Supreme Court, the Court of Appeals and perhaps one or two provincial courts. Reform of salaries, allowances and benefits for these courts must be tied to a fresh recruitment based on more rigorous criteria and clear codes of conduct. Passage of the long overdue Law on the Status of Judges and Prosecutors is necessary to regularize the recruitment, training, remuneration and retirement of judges as well as to clarify the disciplinary action that can appropriately be taken.

35. These three steps need to be accompanied by a number of other measures. The adoption of modern codes of civil and criminal procedure that reflect the needs of Cambodians today and that are based on adequate consultation, and their wide

dissemination through training and other means, will help the functioning of the legal system. Laws need to be published and widely disseminated, and court judgments need to be reasoned and made public. Reform of the Bar Association so that it enforces proper codes of conduct on its members will help. Reform of the police and prosecution system will also be needed if improvements in criminal courts are not to be subverted by incompetent and corrupt investigation of cases.

36. While the formal legal system is being reformed, the draft action plans are rightly stressing alternative dispute resolution. Foreign investors rely on international commercial arbitration, but domestic investors would benefit from an alternate dispute resolution center that would be facilitated by a law on commercial arbitration. Local conflicts are settled largely outside the formal legal and judicial system (see Chapter 4) through the cadastral commission and commune and village level dispute resolution committees. It is important to better understand how these work and how they can be strengthened further.

37. The noble goal of establishing the ‘rule of law’ will prove elusive until all Cambodian government officials consider themselves bound by the law, and until all individuals are treated equally and with dignity by the law and that justice is accessible to all. This will only happen when there are major changes in political, social and economic relationships in Cambodian society that shift the incentives facing government officials (Gary Goodpaster, 2003). It is, therefore, important to be realistic about what reforms in the judiciary can be expected to achieve. An increase in the budget for the Ministry of Justice would be an important signal from the Government of heightened commitment to legal and judicial reform in Cambodia. And donors can also help by increasing public awareness in Cambodia about the importance of an effective justice sector for restoring growth and fighting poverty.

***Is an Anti-Corruption Commission the answer to a malfunctioning judiciary?***

38. Governments with malfunctioning justice sectors are beginning to increasingly turn to anti-corruption commissions to address corruption issues in the judiciary itself and elsewhere. Cambodia’s Rectangular Strategy commits the government to “promote the implementation of the Anti-Corruption Law and create an independent body to fight corruption” (Royal Government of Cambodia, The Rectangular Strategy, 2004) but also “to take concrete actions that attack the roots of corruption” (Royal Government of Cambodia, The Rectangular Strategy, 2004). The draft Anti Corruption Law falls well short of international best practice as embodied in the UN Convention against Corruption (UNCAC), and there are serious questions about its internal coherence, compounding the inevitable problems of implementation and enforcement. It defines corruption broadly, which is the right way to go, but fails to define better its many dimensions. Nepotism and conflict of interest are addressed only inferentially. Greater clarity is needed on the requirements relating to declaration of assets: who it applies to, the need for such information to be made public, and the penalties associated with

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failure to declare. Well functioning and independent asset declaration systems are a useful deterrent to corruption. The law also fails to prohibit laundering or concealment of the fruits of corruption. Early action is needed to bring the law into conformity with UNCAC prior to its enactment. Accompanying regulations should use bright line rules that provide simple prohibitions that are not open to more than one interpretation.

39. The proposed Supreme National Council for Anti-Corruption is to be the principal vehicle for implementing the new law. The track record for similar bodies in other countries is not encouraging, and the conditions under which they succeed are rather demanding for a country with weak institutions (Patrick Meagher, 2002). If the Council is to work, it will at the very least need members of outstanding integrity and independence, and an adequate budget to do its work. The government also needs to ensure a supportive environment in which the independence and authority of the Council is respected and protected from political interference. The police and judiciary will need to work with, and not against, the Council if its decisions are to be enforced. The new Council will also need to be strategic and selective in setting its agenda, so that it does not spread itself thin, a common mistake made by other such bodies. Finally, a number of other complementary laws will be necessary to facilitate the work of the Council, such as a Freedom of Information Law, a Witness Protection Law and libel laws that protect the media from aggressive prosecution for reporting corruption. Cambodia will also benefit from international experience in the fight against corruption. It has already signed on to the ADB-OECD's Asia Region Anti Corruption Initiative. It needs now to become a signatory to the UN Convention against Corruption which has been signed by over 100 countries including most of Cambodia's ASEAN partners. Enforcement is critical to reducing corruption. But attacking the roots of corruption requires addressing the failures of accountability described earlier in this chapter. It is to this that we now turn.

### **E. Improving Public Financial Accountability**

40. Governance failures systematically undermine the role of the Royal Government's budget as an instrument of service delivery and poverty reduction. As seen above, the entire chain of accountability from inadequate policy direction and oversight by the National Assembly to almost non-existent external accountability by way of external audits and civil society oversight is deeply flawed. Moreover, low revenues drive under-funding of the budget in part because a corrupt and weak bureaucracy is unable to mount a serious revenue effort. Under-funding in turn drives corruption because it robs civil servants of sufficient pay and other resources that they need to do their job. There are four key components to improved public financial accountability:

41. ***Reform must begin with an improved revenue effort.*** The new government is committed to raise revenues from their current inadequate 10% of GDP, well below the

average for low income developing countries (16%) to around 14% by 2009, which given declining growth prospects will not be easy without a substantial improvement in customs and tax administration. Such an improvement should not have to await a major civil service reform. Rather, the new government needs to consider piloting a major overhaul of incentives and performance management in the tax and customs department. It should do this either through an autonomous revenue authority – an approach tried successfully in many countries – or through a merit and performance based system in select departments or units. Improved non-tax revenues will require governance reforms in natural resource management, greater transparency in the use and lease of state assets, including strengthened management of government concessions, such as those relating to the Angkor complex.

42. ***The effectiveness of public spending on poverty oriented programs must be enhanced.*** Since 1998 the Government has significantly improved the alignment of resources with its developmental objectives through significant real increases in spending on priority sectors from 1.4% of GDP to 3.2% of GDP. And Cambodia plans to further increase the share of priority sectors in the coming years. This has already made education spending much more pro-poor, while health spending lags behind. However, this has yet to make a significant impact on social indicators reflecting the need to improve the effectiveness of spending by linking it much more closely to priority outcomes and by strengthening the mechanisms of accountability. Improving the accountability mechanisms and access to information that would help civil society and citizens hold government accountable for poor service delivery will be crucial to enhancing the impact of poverty reducing expenditures.

43. ***The fiduciary risks to public funds must be reduced.*** The fiduciary risk to public funds is high because of weaknesses in all three dimensions of public financial management: budget formulation, execution and reporting. Cambodia's system is rated below average compared to its peers among low income countries. Accountability is weak, transparency is low, and corruption is reported to be very high. Reforms are needed from the top to the bottom of the accountability chain. Parliamentary oversight needs strengthening. The Finance and Banking Committee (FBC) of the National Assembly needs to open its deliberations to the public and give itself and the National Assembly enough time to debate and discuss the budget. Strengthening the secretarial support to the FBC and helping members of the National Assembly better understand and contribute to budgetary policy making will help. The control environment for public spending needs to be improved. Shifting from a cash based payments system to bank transfers will help reduce the considerable abuse and the practice of facilitation payments to the Ministry of Economy and Finance and line ministries from government agencies. Internal financial controls need strengthening and the relatively new National Audit Authority needs further strengthening, and its reports need to be made public. Late release of budgets – nearly a third of all civil recurrent expenditures in 2001 were released in the last month of the year – which also contributes to poor financial management practices. Lack of transparency in budget processes contributes to weak

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accountability. The budget needs to be made more accessible to the public and civil society needs to be consulted at all stages of the budget cycle. This will require efforts to train NGO staff to better understand budgetary issues and practices.

44. Public procurement remains a principal source of corruption. While competition in procurement was formally introduced two years ago, it is still managed without effective competition or much transparency. The private sector complains that all short-listed parties are subject to informal fees for the privilege. The reliance on sole-source concessions for Build-Operate-Transfer projects has created a closed environment for the award of such concessions and encouraged direct negotiations with questionable outcomes. Reforms must include a clear sovereign law that supercedes the numerous and conflicting decrees, independent monitoring of procurement by civil society and the private sector, and greater transparency of the process including wide advertising and publication of outcomes.

45. Recognizing these problems, the Ministry of Economy and Finance's newly appointed Reform Committee has developed a public financial management reform program, endorsed by the Prime Minister, with a strategy statement and a rolling, prioritized action plan, a performance management framework and complementary organizational and management reform components. Many of the highest priority items in the Government's action plan are set for implementation according to a timetable agreed with the PFM partners. Serious political commitment to such a reform program by the new government will need to be matched by adequate donor support for it. Partners have recognized that they can improve their provision of technical assistance to the Government, based on recent experience. The most difficult problems—fragmented and contradictory advice from partners, lack of alignment of assistance with Government plans, lack of accountability of assistance to Government, and lack of Government leadership—have been addressed with the establishment of the PFM sector wide approach. This opens the way for early progress in this area.

46. ***Reducing fiduciary risk will ultimately require a reformed civil service.*** An underpaid and patronage based civil service is a recipe for high corruption. The Rectangular Strategy calls for a 10-15% per annum increase in civil service pay, accompanied by "special attention" to the management of civil servants (Royal Government of Cambodia, The Rectangular Strategy, 2004). Such special attention should take the form of a merit based management system accompanied by higher and decompressed pay consistent with fiscal sustainability. This will inevitably be a long term program given fiscal constraints. In the short term, the likely path for civil service reform is through a parallel phased introduction of merit based management and higher decompressed pay for selected high priority sectors, functions, and skills. Higher pay will be easier to bring about in the medium term if a functional review is undertaken to gradually rationalize and redeploy staff across sectors and regions addressing shortages of skills and staffing in some areas and surpluses in others. Finally, the government's commitment, in the Rectangular Strategy, to a politically neutral civil service needs to

be welcomed. Such neutrality needs to be firmly embedded in the way civil servants are recruited, promoted and transferred. This must be accompanied by a clear code of conduct that restricts civil servants from all partisan activities or actions or those which conflict with their responsibility to protect the public interest. Despite considerable work, progress to date on civil service reform has been disappointing. A prioritized, sequenced strategy and action plan for introducing the features of a meritocratic civil service with enhanced pay scales in a few high priority sectors, agencies and functions now needs to be developed for endorsement by Cambodia's partners.

#### **F. Decentralization: Bringing Government Closer to the People**

47. Cambodia has embarked on an impressive process of decentralization which carries both risks and opportunities. Weak capacity at lower levels of government and high fiduciary risks can increase opportunities for corruption. At the same time, decentralization could over time shorten the route of accountability, bringing government closer to the people. Cambodia's Rectangular Strategy rightly notes that proper implementation of decentralization and deconcentration "is crucial to the strengthening of democracy at the grassroots, improving the quality of public services and promoting the culture of participation and participatory local development in all sectors" (Royal Government of Cambodia, The Rectangular Strategy, 2004). The first two years of decentralization have seen considerable progress. The basic systems and processes have been established all over the country, thus enabling the elected commune and sangkat councils to begin functioning. Inevitably, there are design problems that need correction. This in part reflects the hesitancy that marks these tentative steps towards subnational democracy. Given the troubled history of Cambodia, a certain amount of caution and risk aversion is understandable. At the same time, the experiment is already showing immense promise and it is important that it not fail. Three steps are needed to put this initiative on a firmer footing.

48. ***Develop a broadly shared long term vision for governance at the subnational level:*** Articulating a vision for the nature of decentralized governance in the long term will provide direction and focus to policies and programs that take this initiative forward. This vision needs to embrace all tiers of government: the provinces, the districts and the communes, and attempt to correct the current overly centralized powers vis-à-vis the subnational tiers. A road map on how to get to the long term goals would help guide and strengthen the processes that are essential for success, such as participatory planning, fiscal transfers and service delivery. A consultative exercise that draws on the initial lessons from two years of decentralization will not only help develop a shared national consensus on the directions for change but also allow for some mid-course corrections, clarifying responsibilities and functions, and identifying the legal and policy framework needed to ensure progress towards the longer term goals. The recent initiative to establish a joint government donor Technical Working Group (TWG) on decentralization and deconcentration that would develop a strategic

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framework and action plan in this area provides an opportunity to take this work forward.

49. ***Clarify and strengthen internal and external accountabilities of the communes and sangkats.*** Currently, commune councilors are accountable to their electorates, to the leaders of the political party to which they are affiliated, and to the provincial and central governments. Being pulled in different directions, they are prone to yield to the most powerful: the ruling political party leaders. Accountability is compromised by a number of other factors. Commune budgets are subject to the same weak public financial management that prevails at the Center. Communes have no staff of their own and councilors lack authority over the public officials responsible for the delivery of services, since the latter are part of the provincial government, which in turn is entirely beholden to the Central government. Furthermore, civil society is unable to play an effective role in influencing the outcomes of commune budgets because of the lack of transparency and inclusiveness in commune and sangkat processes. Enhancing the voice of citizens and the influence of civil society, and clarifying and strengthening financial accountability are high priorities if the communes and sangkats are not to soon succumb to the same financial practices and corruption that prevail in the central government. The central government should also better monitor the performance of local governments in service delivery to encourage healthy competition between communes/sangkats. It is also critical that communes be allowed to increase their own revenue mobilization efforts not only to supplement central transfers but to enhance accountability to local taxpayers.

50. ***Increase the predictability, reliability and level of funds transferred to communes*** and assist communes to strengthen their own revenue collection efforts. Slow and incomplete cash transfers have made it difficult to fund commune work programs. Early establishment of the Commune/Sangkat Fund board that oversees and takes responsibility for the management of funds for communes (which come mainly from external aid to Cambodia) is a high priority. Moreover, there are large genuine needs for poverty-reduction related programs which remain unmet by the paltry \$6,000 average size of annual grants to communes and sangkats, a paltry 75 US cents per capita. The government needs to follow up on its recognition in the Rectangular Strategy of the need for “reasonable levels of financial resources to the communes” (Royal Government of Cambodia, The Rectangular Strategy, 2004) by gradually raising allocations for this purpose.

## **G. Managing Natural Resources for the Public Good**

51. All formal property rights were destroyed by the Khmer Rouge, and the large scale displacement of populations undermined traditionally recognized claims on natural resources. In addition, following the end of civil war, lingering physical insecurity and weak enforcement of property rights led to rapid exploitation of resources

to the detriment of sustainability. High demand for unofficial revenues to support a poorly paid and patronage based civil service and military and to fund political campaigns provided additional incentives for trading away sustainable use of resources for short term financial gain.

52. About 75% of Cambodia's land area is technically under State management, including virtually all forested areas, much of the marine and fresh water resources, cultural heritage sites and large scale agricultural properties. The government's primary mechanism for management of natural resources has been to contract large areas to Cambodian and foreign investors. These concessions were usually granted through seemingly ad hoc and non-transparent processes. Designation of resources was not based on feasibility assessments; investors were not adequately screened to ensure technical and financial capacity to fulfill contractual obligations; and government institutions were unable to enforce the provisions of contracts. The direct revenue from concessions has been far below expectations, while the contribution of these concessions to growth and employment has been rather modest. The environmental consequences have been extremely negative. As a result, local communities have seen few benefits from these concessions. Landlessness is now estimated at 12-15% while average farm size is reportedly declining.

53. The Government has signaled at the highest levels its acknowledgement of the shortcomings of these policies and has cancelled some 40% of all concessions accounting for half the original area under concessions. In addition a suspension of logging in concessions has been in effect for over 18 months. The government is now committed to reorient natural resources policy consistent with the objectives of the Rectangular Strategy, and is increasingly exploring community based and benefit sharing approaches. Such a reorientation will require a number of steps.

54. ***Reform must begin with laying sound policy and legal foundations for natural resource management.*** A broad based consultative policy process is needed to develop a vision for natural resource management by the state. This process needs to explore the major trade-offs, including those between continued maintenance and expansion of forested and fisheries area, and pressures to expand land under agriculture and those between small-holder and community managed approaches versus commercial approaches. These trade-offs need to be informed by natural resource assessments and mapping of state lands. Several laws covering natural resources have been recently enacted or are under consideration. These need to better describe the hierarchy of claims to state resources, the mechanisms for resolving inconsistencies between these laws and those for resolving conflicting claims on resources. Property rights to natural resources need further clarification.

55. ***The institutions responsible for natural resource management need to be made more accountable and transparent.*** Institutional responsibilities are both concentrated and centralized in Cambodia. Concentration of functions in one agency at

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the national level has resulted in little attention to policy trade-offs and reduced checks and balances. Policies have been crafted without adequate consultation with those directly affected. When consultations did take place as with the Land Law, the benefits were significant. Reforms must include addressing the perverse incentives facing these institutions which result in their capture by vested interests. These include the perennial issues of civil service salaries and weak and patronage-based management. External checks and balances need to be strengthened including parliamentary oversight and external accountability including through the National Audit Authority. Required consultations with local communities and public disclosure as mandated in the subdecree on forest concessions management should be extended across all natural resources. Monitoring of state agency performance by civil society should become the norm.

56. ***Given that 85% of Cambodia's population lives in rural areas, with a large proportion poor, resource management approaches need to prioritize direct access of local communities to benefits from such approaches.*** Privatization of land in favor of individuals through recognition of their occupancy rights under the Land Law is considered likely and social concessions will also transfer land out of the public domain. Implementing the unused land tax will help prevent speculative land holdings and release additional land to the market. However, the bulk of natural resources are likely to stay in state hands. Concession arrangements may still be a good management approach provided these arrangements are transparent and accountable, and require consultation and sharing of benefits with local communities. Increased benefit sharing should also be required of all ongoing concession arrangements and state lands. Local communities can share both access to resources and direct monetary benefits. Local partnership approaches will shift the responsibility for generating public goods to a broader spectrum of local actors, including communities and commune councils and district and provincial staff. The challenges in generalizing local benefit sharing should not be underestimated. Care will be needed in particular to avoid elite capture and marginalization of the poor.

57. ***A high priority is to mitigate the not inconsiderable risk of land-grabbing*** as new institutional and management arrangements are put in place while large volumes of land come under state management from cancellation of concessions without a corresponding increase in the state's capacity to manage these. The best hope is to develop collaborative arrangements with local communities which extend the capacity of government agencies. NGOs in Cambodia already have experience with collaborative monitoring and enforcement. A multi-stakeholder system supported by independent monitors will require a rapid mobilization of government and donor resources to put in place.

## H. Removing Governance Obstacles to Investment and Growth

58. Given the parlous state of its public finances, Cambodia has little choice but to rely on domestic and foreign private investors to finance much of the country's investment, to provide key infrastructure, and to be the principal engine of growth. Yet, governance obstacles heavily impinge on the private sector's ability to respond positively to this challenge. A malfunctioning justice sector greatly increases uncertainty and risk, particularly from arbitrary state action. Corruption increases the cost of starting and doing business in Cambodia to a point where it is threatening the country's relative competitiveness. And lack of transparency in dealings between the government and the private sector, particularly in the area of concessions and BOT type arrangements, encourage unscrupulous businesses to attempt state capture and reduce potential revenues to the exchequer from such arrangements. The Rectangular Strategy recognizes this, noting the need to strengthen both public and corporate governance and improve the investment climate (Royal Government of Cambodia, The Rectangular Strategy, 2004).

59. ***The regulatory burden on the private sector needs to be eased.*** The formal private sector faces a vast number of transaction costs and barriers to the establishment and operation of business. It takes 94 days to start a business in Cambodia, 30 days longer than in Vietnam, and 52 days longer than in Thailand. Trade facilitation practices are subject to high official and unofficial costs, delays, uncertainty and discretion. Cambodia is also among the slowest places to clear imported goods, vital for the country's nascent export industry, with a large number of agencies vying with each other to control such imports. As noted above, corruption is seen as so acute that private enterprises rank it above all the many other difficulties they face when operating in Cambodia. Fear of regulation drives many companies to stay informal and outside the government's net, a practice that carries its own costs. Reform will require clearing the undergrowth of regulations, disentangling overlapping jurisdictions of government agencies and following a risk management strategy towards controls.

60. ***Market supporting institutions need to be strengthened.*** In the absence of market supporting institutions such as an effective legal and judicial system, there are no mechanisms to ensure a level playing field, to resolve disputes between government and the private sector, and to help enforce contracts. Reforming the justice sector, as noted above, will take time. In the meantime, the government must address the widely held perception that a handful of conglomerates and firms with close ties to the political leadership exercise undue influence over policies. Broadening the dialogue with the private sector, in a manner that gives effective voice to other players and is seen to result in policies and practices that ensure competitive and fair markets, will be crucial to building confidence until market supporting institutions begin to play an effective role.

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61. ***Competition and transparency are needed in the private provision of infrastructure.*** Lack of competition has also been a key drawback in the private provision of infrastructure in Cambodia. As in most developing countries, the state in Cambodia has little capacity to provide infrastructure with its limited administrative and budgetary resources. Yet the tendency to directly negotiate contracts with private contractors without competitive bidding has resulted in projects not being commissioned on a least cost basis, and not meeting technical criteria that would limit the likelihood of delivery failure. The current legal and regulatory framework governing Private Provision of Infrastructure (PPI) is inadequate. Nor is there adequate planning and policy work that guides the development of infrastructure. There are few clearly defined procedures for processing unsolicited applications for PPI, and this results in total lack of transparency at all stages of implementation of such projects. These projects are often financed entirely by equity, partly to avoid scrutiny by a financial institution. This tends to drive up the expected rate of return. Lack of information on these projects makes it difficult to assess whether the public is getting adequate value in return for concessions of public assets such as land or public ownership rights. And the lack of proper laws implies that arbitrary decisions cannot be easily checked and the public interest cannot be easily protected.

62. Unsolicited or directly negotiated projects create opportunities for grand corruption and reduce public trust in government. Reform must begin with greater transparency on all such contracts. All contracts should be made publicly available, as is the practice in Mexico where they must be placed on government websites. A clear policy framework is needed, including the enactment of laws and regulations that establish clear transparent and accountable processes for PPI. And all existing contracts need to be audited with a view to ascertaining if the public interest is being served. The Ministry of Commerce, Ministry of Finance and the Council for the Development of Cambodia have begun work in this direction.

### **I. Conclusion**

*“...The successful solving of the political deadlock within a peaceful and stable environment and in a renewed spirit of national reconciliation and democracy has provided us with a renewed and hopeful opportunity to embark on faster pace, more diversified and in-depth reforms in all the sectors where we have started in earlier terms....Cambodia has no other better choice than moving forward with all these steadfast reforms. With commitment to continued reforms, our chance to survive would be 90%, while surrendering the reforms the chance would drop to only 10%.”*

***--Samdech Hun Sen, Prime Minister of the Royal Government of Cambodia<sup>8</sup>***

63. The Royal Government clearly recognizes, as is evident from the above statement by Prime Minister Hun Sen that Cambodia is at a critical juncture in its

history. Much has been achieved over the past decade, but much remains to be done to break the stranglehold of poverty that grips the bulk of the population. Failure now to accelerate reforms will prove very costly for Cambodia's poor and for its future as a country. Without urgent efforts to remove governance impediments to investment and economic diversification, growth will decelerate sharply in the medium term. Without a serious effort to improve public financial accountability or to better manage the country's natural resources, the poor will pay a high price in terms of their human and physical capital.

64. This is not to suggest that the task ahead will be easy. Major structural and institutional reform will be needed. Such reforms will threaten powerful interests within and outside government and will be resisted. It will be very tempting to substitute process for genuine reforms. Process is important. But it often becomes an end in itself when the commitment to reform is weak, driven as it is by the desire to feed donor need to see some progress rather than by strong conviction and consensus. Thus Cambodia is indeed at the crossroads. It can choose to pursue reforms vigorously, empowered by broad local ownership, aimed at fundamentally changing the incentives that currently undermine long term sustainable development. Or it can continue to muddle along, with severe adverse consequences for the poor. The choice, as the Prime Minister recognizes, is indeed stark.

65. Given the human and institutional constraints facing Cambodia, the path of reforms is unlikely to be smooth and benefits will take time to be realized. Nevertheless it is important to move strategically in a few key directions and to try to show measurable progress over the next 12 months. Progress and quick wins in a few strategic areas can build political support and momentum and increase the confidence of reformers to stay the course. The considerable work the government has undertaken on public financial management and the private investment climate suggests that in these two areas there is clarity on what needs to be done, and the potential to show early results. Progress on public financial accountability is particularly important if Cambodia's international development partners are to increase their confidence that the development assistance they provide reaches those for whom it is intended. Other priorities will emerge as the underlying analytical work is completed.

*Are Cambodia's development partners a part of the problem?*

66. Cambodia's international development partners are strongly committed to Cambodian development and are anxious to be part of the solution. But they may also be part of the problem. The failure to speak out for Cambodia's poor with one voice or to link financial and technical support to performance and outcomes has sent mixed signals to the country's leadership which has shown itself rather adept at doing just enough to win donor support.

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67. The upcoming Consultative Group meeting marks an opportunity to make a fresh start. The intensified donor coordination effort that has preceded this meeting provides an opportunity to align donor support to a clear and shared message. The volume of bilateral and multilateral donor support needs to be conditioned on the adequacy of Cambodia's reform effort. If reform is forthcoming, donors need to consider ways of financing the likely shortfall in government revenues if growth should slow significantly in 2005 and beyond.

68. As Chapter 1 notes, growth is likely to fall significantly in 2004-2005 and is not likely to recover to the National Poverty Reduction Strategy (NPRS) target of 6-6.5% until 2009. Given this scenario, if Cambodia is willing to undertake the necessary governance reforms to improve its investment climate, it is imperative that donors are able to respond to Cambodia's needs to restore growth as much as possible during this transition period. During 1999-2003, large aid inflows, which averaged 12% of GDP, helped finance domestic investment and fueled construction activities (IMF, 2004). About half of the inflows were grants in the form of donor-financed projects and technical assistance, all of which were outside the budget. Aid inflows were used to improve health and education (24%), rebuild physical infrastructure (23%), and strengthen economic and social institutions (15%). Agriculture and forestry received only 8% of aid flows.

69. It is now time to review the current allocation of foreign aid flows with a view to focusing more on the growth agenda. Although weak administrative capacity may have required that during 1999-2003 about 50% of all aid flows be used for technical cooperation, a reallocation may be needed to more directly address poverty and boost long term growth. The enormous need to raise rural incomes argues for greater investments in agriculture and in rural infrastructure that links farms to markets. These investments would of course be predicated on the Government first designing adequate policy and investment strategies for these sectors.

70. Donors also need to ensure that technical assistance builds Cambodia's own capacity instead of substituting for it. Dependence on expatriate advisors is excessive: some 800 advisors who collectively cost donors more than the government's wage bill. Reliance on such advisors for reform processes or project management undermines national ownership and institutional capacity building, especially when these advisors are weakly integrated into the mainstream of internal government processes (Godfrey, et al 2003; Mysliwiec 2004). A time bound medium to long term program needs to be developed to reduce and eventually phase out foreign advisors and replace them with Cambodians. This needs to be accompanied by a program to replace the current practice of ad hoc salary supplements to Cambodian officials working on donor funded projects with a system of transparent payments to carefully selected priority groups critical to improve service delivery for the poor. Such a scheme would need to be linked to improved performance management of civil servants in chosen ministries (Chapter 3). It would also need to ensure such support over a sufficiently long period of

time (10-15 years) to allow Cambodia to increase its budgetary revenues sufficiently to ensure the civil service a living wage.

71. Donors also need to reduce the cost to Cambodia from failures in donor coordination. Aligning donor programs with the government's development program, ensuring that all donor assistance is recorded in the budget, undertaking joint analytical work, relying more on Sector Wide Assistance Programs, and harmonizing donor procedures to reduce the burden of the current wide variety of donor policies and practices that government must follow to qualify for assistance. The proposed Harmonization Action Plan to be considered at this meeting of the Consultative Group would begin the process of reform on the donor side. A first important step would be to provide coordinated assistance to the Government's next five year plan for 2006-2010 which will seek to develop the policies and investments that will turn the vision of the Rectangular Strategy into a reality for Cambodia.

72. The Royal Government of Cambodia and its international development partners face a unique opportunity to significantly accelerate the reform process at what appears to be a propitious time in the country's history. The leadership for this must come from Cambodia? Will Cambodia's leaders seize the moment?

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## End Notes

<sup>1</sup> Royal Government of Cambodia, *The Rectangular Strategy for Growth, Employment, Equity and Efficiency in Cambodia*, Prime Minister Samdech HUN SEN and The Third Legislature of the National Assembly, At The Office of the Council of Ministers, Phnom Penh, 16 July 2004, p12.

<sup>2</sup> Ibid. p.2.

<sup>3</sup> UNDP and SIDA, Cambodia Millennium Development Goals Report 2003, in passim.

<sup>4</sup> Cambodia Development Resource Institute (CDRI), supported and supervised by the Asian Development Bank (ADB), *Cambodia: Enhancing Governance for Sustainable Development*, April 2000., para 38

<sup>5</sup> The *principal* may be the politician and the *agent* the bureaucrat. Or the *principal* may be the head of an agency or principal civil servant, and the *agent* may be the front-line service provider (such as the head of the postal department and the postman). The *principal-agent* problem arises because the interests of the *principal* and the *agent* diverge. The *principal* lacks sufficient information about the *agent's* behavior ("asymmetry of information") and *agents* have an incentive to hide information. An *agent* will be corrupt when in his judgment the benefits of doing so exceed the costs. Costs, here, refer to the risk of discovery and punishment, or the loss of personal reputation and self respect. Robert Klitgaard's stylized equation: CORRUPTION=MONOPOLY+DISCRETION-ACCOUNTABILITY implies that corruption is a matter of removing or restraining the monopoly over service delivery, reducing discretion in the hands of agents and increasing accountability for their actions (Robert Klitgaard, *Controlling Corruption*, Berkeley: University of California Press, 1988, p. 69-75.) This model assumes that the *principal* is free of corruption. Often, this is not the case, and the *principal* and the *agent* may conspire against the ultimate *principal*, the citizen.

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<sup>6</sup> These issues were raised in a communication to the Royal Government from the informal donor working group on legal and judicial reform dated 16 July 2004 addressed to H.E. Sum Manit, Chair of the Permanent Coordinating Body of the Council for Legal and Judicial Reform.

<sup>7</sup> The Council comprises the King, the Minister of Justice, the President of the Supreme Court, the General Prosecutor to the Supreme Court, the Chief of the Court of Appeal, the General Prosecutor to the Court of Appeal, and three judges elected by the judiciary for a five year term.

<sup>8</sup> Address to the Seventh Royal Government-Private Sector Forum, Government Palace, August 20, 2004.

<sup>9</sup> Godfrey et al 2003; Mysliwicz 2004.