EXPENDITURE POLICY TO PROMOTE GROWTH: CAMBODIA

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Development Discussion Paper Number: 2006-2

Abstract
The objectives of this paper are to identify the most important constraints to achieving higher rates of pro-poor growth in Cambodia, and to propose some public sector expenditure policies that might address these constraints. The approach taken in this study is to look at the objectives, size, composition, and financing of government expenditures since the late 1990s to the present time.

There are three problems facing Cambodia that we take up in this paper that public sector expenditure policies in the next years should address. First, there is a high incidence of poverty, particularly in the rural areas (90 percent of the poor), with at least 4 million in 2000 falling below the poverty line. Much of this poverty is caused by the lack of food security. Second, the system of public administration is weak. Third, the amount and quality of the infrastructure is very low outside of the main cities.

Prepared for: The World Bank Cambodia Mission Phnom Penh, Cambodia, September 2006.

JEL code(s): I32, I38

Key words: Cambodia expenditure allocation, administrative reform, pro-poor growth, poverty alleviation.

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Prepared for:
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Phnom Penh, Cambodia

ACKNOWLEDGEMENTS

During its preparation we have benefited greatly from discussions and assistance from a number of public and private sector individuals. These include, among others,

Mr. Julian Abrams, Program Advisor, SEILA Program
Mr. Björn Bengtson, Managing Director, Swedish Institute for Public Administration (SIPU International)
Mr. Julien Calas, Director of Mission, AfD
Mr. Ruos Sam Ear, Director, Planning Development Department, Ministry of Tourism (MoT)
Mr. Alain Goffeau, Project Implementation Specialist, Cambodia Resident Mission, Asian Development Bank (AsDB)
Mr. Robert P. Hageman, Resident Representative, IMF
Mr. Sam C. Herrera Jr., Vice President, Cambodia Hotel Association (CHA)
Mr. Khun Jolin, Deputy Director, Department of Investment and Cooperation, Ministry of Economy and Finance (MEF)
Eng. Mour KimSan, Deputy Director General, General Department for technical Affairs, Ministry of Rural Development (MRD)
Mr. Scott Leiper, Director, SEILA Program
Dr. Ken Loo, Secretary General, The Garment Manufacturers' Association in Cambodia (GMAC)
Mr. Jacco Minnaar, Program Manager, Financial Market Development, International Finance Corporation (IFC)
H.E. Ou Orhat, Secretary of State, Ministry of Planning (MoP)
Mr. Theng Pagnathun, Director, PIP unit, Planning Investment Department, Ministry of Planning (MoP)
Mr. Seilava Ros, Director, Economic and Public Finance Policy Department, Ministry of Economy and Finance (MEF)
Mr. James L. Seward, Financial Sector Specialist, Financial and private Sector
Development Unit, East Asia and Pacific Region, WB
Dr. Farid Sidiqui, Senior Advisor / Program Manager, Aid Coordination and Partnerships, Council for Development of Cambodia, Ministry of Economy and Finance (MEF)
H.E. Veng Sakhon, Secretary of State, Planning Department, Ministry of Water Resources and Meteorology (MWRM)
Ms. Heang Siekly, Deputy Director General, General Directorate of Planning, Ministry of Planning (MoP)
Eng. Chan Sodavath, Executive Director, Corporate Planning and Projects, Electricity of Cambodia (EDC)
Mr. Chhay Soeun, Finance Department Manager, ACLEDA
Mr. Nget Sokhan, Chief Corporate Finance, Project Financial Controller, Electricity of Cambodia (EDC)
Mr. In Someth, Deputy Director, Department of Economic and Public Finance Policy, Ministry of Economy and Finance (MEF)

Mr. Va Sim Sorya, Director, Planning Department, Ministry of Public Works and Transport (MPWT)
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Mr. Phiyorin Tep, Head of Macroeconomic Office, Economic and Public Finance Policy Department, Supreme National Economic Council (SNEC)
Mr. Ly Thay, Operations Department Manager, ACLEDA
Mr. Nao Thouk, Director General, Department of Fisheries, Ministry of Agriculture, Fisheries and Forestry (MAFF)
Mr. Korezumi Tomoaki, Second Secretary / Infrastructure Office: Roads, Japanese Embassy
Mr. Pich Veasna, Director, Planning and International Cooperation Department, Ministry of Water Resources and Meteorology (MWRM)
Mr. Pen Vuth, Director, Department of Agronomy and Agricultural Land Improvement, Ministry of Agriculture, Fisheries and Forestry (MAFF)
Mr. Srey Vuthy, Director, Planning Department, Ministry of Agriculture, Fisheries and Forestry (MAFF)

We are greatly appreciative the support, comments and suggestions provided to us by Mr. Robert Taliercio, Country Economist, World Bank Cambodia Mission, Phnom Penh, Cambodia. The continuous assistance of Mrs. Varony Ing, World Bank Cambodia Mission, in coordination of logistical matters has been critical in undertaking this study.

The opinions and recommendations set forth in this report are those of the authors and all errors and omissions remaining are responsibility of the authors.

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ABBREVIATIONS

AsDB	Asian Development Bank
CAFIMEX	Cambodia Fish Import and Export Company
CAR	Council for Administrative Reform
CDRI	Cambodia Development Resource Institute
CARDI	Cambodia Agricultural Research and Development Institute
CDC	Council for the Development of Cambodia
EIRR	Economic Internal Rate of Return
ENPV	Economic Net Present Value
EPU	Economic Planning Unit
ERA	Emergency and Relief (humanitarian) Assistance
EU	European Union
FAO	Food and Agricultural Organization
FIRR	Financial Internal Rate of Return
FNPV	Financial Net Present Value
FOA	Food Aid
FRMR	Fund for Repair and Maintenance of Roads
FTC	Free-standing Technical Co-operation
GDP	Gross Domestic Product
IFAPER	Integrated Fiduciary Assessment and Public Expenditure Review
IMF	International Monetary Fund
IPA	Investment Project Assistance
ITC	Investment-related Technical Co-operation
MAFF	Ministry of Agriculture, Forestry and Fisheries
MEYS	Ministry of Education, Youth and Sports
MOC	Ministry of Commerce
MOE	Ministry of Environment
MOEF	Ministry of Economy and Finance
MOH	Ministry of Health
MOI	Ministry of Interior
MLMUPC	Ministry of Land Management, Urban Planning and Construction
MOP	Ministry of Planning
MPWT	Ministry of Public Works and Transport
MRD	Ministry of Rural Development
MTEF	Medium Term Expenditure Framework
MWVA	Ministry of Women's and Veterans' Affairs
NGO	Non Governmental Organization
ODA	Official Development Assistance
PAP	Priority Action Program
PBB	Program/Budgetary Aid or Balance-of-Payments Support
PDAFF	Provincial Department of Agriculture, Forestry and Fisheries
PDWRAM	Provincial Department of Water Resources and Meteorology
PPWTD	Provincial Public Works and Transport Department
PIP	Public Investment Plan
PRASAC	Support Program for the Agricultural Sector in Cambodia
PRDC	Provincial Rural Development Committee
PRSP	Poverty Reduction Strategy Paper
RGC	Royal Government of Cambodia
TOFE	Table of State Financial Operations
UN	United Nations
WB	World Bank
WFP	World Food Program

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Summary

1. INTRODUCTION

The objectives of this study are to identify the most important constraints to achieving higher rates of pro-poor growth in Cambodia, and to propose some public sector expenditure policies that might address these constraints. The approach taken in this study is to look at the objectives, size, composition, and financing of government expenditures since the late 1990s to the present time.

There are three problems facing Cambodia that we take up in this paper that public sector expenditure policies in the next years should address. First, there is a high incidence of poverty, particularly in the rural areas (90 percent of the poor), with at least 4 million in 2000 falling below the poverty line.[1] Much of this poverty is caused by the lack of food security. Second, the system of public administration is weak. Third, the amount and quality of the infrastructure is very low outside of the main cities.

2. EXPENDITURE ALLOCATION

1. Size of Public Spending. The size of public expenditure, broadly defined and including external assistance financed projects, humanitarian aid, and treasury-executed expenditures rose from 23.0 percent of GDP in 1998, but has since been rising to 25.3 percent in 2002 and 24.6 percent in 2003. Treasury executed expenditures include expenditures financed from internal government resources (revenues) as well as expenditures co-financed by development partners. Over the past decade the treasury-executed component of total public sector spending has moved with a general rising trend in a highly irregular pattern within a range 9.0 to 12.9 percent of GDP.

2. Spending in Priority Sectors. The RGC has chosen education, health, agriculture and rural development as priority development sectors and adopted a series of measures aimed at boosting the economic activity in these fields. Over a period from 1998 to 2001, a sharp increase in Government's spending was witnessed in these sectors. Over the same period, the spending on general administration and judiciary also has risen substantially. At the same time, the RGC managed to cut spending on defense and security. Expressed as a share of GDP, the government's involvement in economic services, rural development, and social services doubled from 2.6 percent of GDP in 1998 to 5.1 percent in 2001.

The total spending on the priority sectors in Cambodia has often been compared to the size of the combined defense and security funding. There is a clear achievement of the government in terms of cutting the defense and security spending in favor of civilian use, specifically the

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[1] Stephen Jones (2004), Background Paper: Contribution of Infrastructure to Growth and Poverty Reduction in East Asia and the Pacific, Oxford Policy Management, pg. 27-30. Here poverty is defined as having an income of less than $1/day.

priority sectors. In 1998, the size of defense and security budget was 43.2 percent of the budget while the priority sectors spending accounted for only 15.9 percent. In contrast, the 2004 actual budget spending was allocated in such a way that the priority sectors received 31.3 percent of the budget while defense and security had only 20.2 percent. Agriculture, transport, public works, and rural development seem to be grossly under funded.

3. Allocation of Funding between Levels of Government. In 1998 the overall proportion of provincially-executed spending was 18 percent, while in 2004 the provinces had 26 percent of the total public sector budget to spend. Whether the decentralization of expenditures to the provinces was a good will depend on the relative administrative capacity of the different levels of government. It is also related to the nature of certain services, such as primary education that in theory could be best delivered by a lower level of government. In Cambodia, where governance is weak, putting more responsibilities on the relatively weaker provincial government could lead to more economic waste.

4. Current Expenditure. Significant changes have occurred in the way the current expenditures are allocated. Two main items in the current expenditure of the government are the salaries/allowances and operating costs. Over the period from 1998 to 2004, the expenditures on salaries and allowances of the civil administration rose from 1.3 percent of GDP to 1.6 percent. At the same time, the operating costs significantly increased over the period 1998-2001 from 1.6 percent of GDP to 3.0 percent. Because of the government's effort to reduce its operating expenditures, there was a reduction in the operating costs of the civil administration from 3.0 percent of GDP in 2001 to 2.1 percent in 2004.

5. Capital Expenditure. There has been an increasing trend in the internally financed and executed capital expenditure (Chapter 50.1) over a period of 1998 to 2002. It increased from 1.0 percent of GDP in 1998 to a sizeable 3.6 percent in 2002. However, the share of capital expenditure undertaken by public sector later declined to 2.1 percent of GDP by 2004. The amount of capital expenditure on new projects has been falling in absolute and relative terms over this period. The total spending under Chapters 50.1-50.3 of the budget reached US$ 92.9 million (2.0 percent of GDP) in 2002, while it amounted to only US$ 77.0 million (1.4 percent of GDP) in 2004. The structure of spending on government's projects is somewhat erratic at the sectoral level, reflecting the impact of a few construction projects on a relatively small government project portfolio.

This reduction was not adequately covered by an increase in maintenance spending under Chapter 30.03, although it has been increased from US$ 4.8 million (0.1 percent of GDP) in 2002 to US$ 13.1 million (0.2 percent of GDP) in 2004. The size of maintenance expenditures remains very small and does not meet the needs of maintaining the stock of existing capital assets.

6. Significance of External Flows. Cambodia has benefited greatly from international assistance on a continuous basis for over a decade. Much of this aid has been technical assistance because of the limited skills existing in the public administration after thirty years of conflict. External financing remains critical for investment in infrastructure and capacity building. The share of external financing has gradually declined from 60.7 percent of the total spending in 1998 to 48.3 percent in 2003. While this trend is expected to continue, it is unlikely that the share of domestic financing will rapidly increase in the medium term. Over the period of 1996-2003, Cambodia received US$ 3,754 million of external assistance, which compares to US$ 3,143 million treasury-executed expenditures over the same time. There has been a gradual shift in the functional composition of external assistance from financing the core government functions to transport, health and education. The question the donors now need to face is whether they should place more emphasis on capital investment or spending relatively less on human capital formation and capacity building.

7. Peace Dividend. First, the peace dividend has been real and the government has made the adjustment of reducing the expenditures on the military, security and also on the core administration, and has managed to reallocate these funds to the social sectors. Second, given Cambodia's history of conflict and massive destruction of human capital, it was correct to emphasize first on education and health, because the public sector need is needed to take the lead in these areas. The question to be raised now is if it's time now to reallocate more government spending to economic active sectors, directly related to employment creation.

2. SPENDING AND RETURNS IN KEY SECTORS

AGRICULTURE, FORESTRY AND FISHERIES

The government spending on agriculture by the two main ministries (MAFF and MWRM) was relatively small until year 2001 when agriculture spending reached 0.4 percent of the GDP, and remained at a level of 0.3-0.4 percent of GDP thereafter. External assistance has provided most of the funding to the sector. The amount of external funding has been 2-4 times the amount that was borne by the government budget on agriculture over 1998-2003.

The administrative allocation of budget between the two ministries and their provincial agencies has been such that the main ministries retain about 60-84 percent of the total budget and provinces access the remaining 16-40 percent share. In terms of execution of expenditures, it is clear that the central ministries have taken the responsibility for the additional capital investments in the sector.

The capital spending by MAFF and MWRM is driven by projects being executed through the ministry. There is no clear defined allocation level that would be maintained over years. The allocation of maintenance funds under Chapter 30.03 of the budget is clearly inadequate to maintain the existing stock of capital assets.

Binding Constraints

Poor infrastructure and support services. There is a clear need to break the weather dependency of crop yields and have an efficient modern system of irrigation. In order to have such efficient system, a primary basic needs assessment should take place in order to survey the available hydro and land resources in the country. Production technology and agriculture knowledge available to the farmers is limited, and most of these are engaged in subsistence farming using low-input, low-output techniques. Poor roads, transportation services and ports represent another formidable obstacle on the way of agriculture produce to markets; such poor infrastructure drives the costs of agriculture products up and reduces the size of farmers' surplus.

Availability and high cost of inputs. The main constraints that farmers face are the quality and price of fertilizers, seeds, equipment and energy. Cambodia does not have the capacity to produce the agriculture inputs that farmers need, and most of these inputs are currently imported from the neighboring countries.

Weak legal and regulatory framework. Cambodia is the case where the private agriculture development is very dependent not only on the public sector infrastructure availability but also on the legal and regulatory policies of the government. The main constraint for the public sector is the lack of effective coordination among the three ministries and lack of a single master-plan that would guide the long-term development of the sector.

Recommendations

Resource Inventory and Needs Analysis Survey. From a brief analysis of the current situation at the various departments at both the MAFF and MOWRAM, it is clear that the decision-makers suffer a lack of detailed technical information of the natural resources in the country.

Sector Wide Planning and Institutional Framework. The present institutional organization is not the most effective form of managing the sector as the two ministries have overlapping functions. In addition, the Ministry for Rural Development (MRD) has extensive involvement into the sector. There is a need to have a clear and effective division of powers and responsibilities among the different bodies, and have a functional system of communication and cooperation among the ministries.

Increase Resource Allocation to Agriculture. It is critical to increase the size and effectiveness of spending in the sector. A clear link between the sector goals and budgets must be established. The government should structure its additional spending on crucial public goods in key accessible geographical areas: irrigation, roads, flood control, fisheries R&D, production technology, and provision of extension services. Agriculture is very dependent on the liberal trade and macro policy, which has been favorably maintained by the government with minimum intervention.

Capital Expenditure and Maintenance. The level of capital expenditure should be raised in order to achieve the desired increase in agricultural output and rural incomes. It is important have a well coordinated and comprehensive development plan that would guide the increased capital spending in the sector. Expenditure on maintenance of existing and new facilities must be taken seriously and responsibility should be taken in regard to who will effectively carry out the routine and periodic maintenance activities.

ROADS AND TRANSPORT

The MEF exercises tight control over capital budget allocations and disbursements to the road projects through MPWT and MRD. There is no systematic process of project identification, preparation and evaluation over the network as a whole. The combined spending by the two ministries in charge of roads (MPWT and MRD) rose remarkably from only US$ 5.3 million in 1998 to US$ 49.1 million in 2004. As the volume of capital spending increased over time, both ministries recorded a reduction in the share of salaries in the budget.

The two central ministries have more execution capacity as compared to the provincial agencies and most of the additional capital flows was handled by the main ministries, which pushed their share of the total budget upward.

In terms of capital spending carried out by the two ministries, there is no clear trend in the amount of capital investment financed from internal sources and categorized under Chapter 50.1. Over a period 1999-2004, the construction and equipment spending by MPWT has been as high as US$ 28.1 million in 2002 and as low as US$ 5.2 million in 1999 and US$ 9.9 million in 2004. The project financed with partial or complete funding from external sources are presented in Chapter 50.2 and 50.3, and the total amount has been also fluctuating over time, driven by the number and size of the projects undertaken by donors.

The MPWT allocation for maintenance of national roads from Chapter 30.03 has been steadily increasing from US$ 4.0 million in 2002 to US$ 12.6 million in 2004. In 2005 the FRMR (road maintenance fund) budget had US$ 17 million to spend on maintenance activities for all sectors. The 2005 FRMR budget does not come close even for the needs of the roads maintenance, not mentioning infrastructure in other sectors.

Binding Constraints

Lack of technical involvement in roads planning and management. The present institutional framework where the national roads belong to MWPT and rural roads to MRD is obviously not the best arrangement that allows for a holistic nation-wide planning and management of the road network.

Limited maintenance funding and coordination. As a consequence of the low capacity for planning and management of the roads system, the current expenditures are heavily biased towards rehabilitation, flood damage repair, and extension activities and very little is channeled to the routine and periodic maintenance of the network. This effectively results in premature loss of assets that otherwise would have been prevented.

Absence of transparent project selection system. The current selection procedure is not based on transparent selection criteria and its linkage to the sector priorities is not known. Such practices discourage an efficient management of the road network, as there is no coherent rationale for selection of projects.

Contracting and procurement. It has been reported that the present procedures do not provide for the transparent selection of contractors, which is bound to result in irregularities in the project procurement and add unnecessary inefficiency to public funds management. The selection is currently not open to any transparent bidding. The RGC has been using the absence of clear selection regulations to employ the military corps of engineers to carry out road contracts.

Recommendations

Operationally independent roads agency. As international practice shows, the best arrangement is to set up an independent body that would manage the available budget according to the needs of the sector. Ideally, the agency should combine both the national and rural networks, and be responsible for planning, management, rehabilitation, maintenance and procurement of all road-related activities in the country.

Project selection system. To assist the task of an independent roads agency, its staff should be adequately trained to carry out the project selection not only at technical level but also at the level of economic assessment for the country. That would ensure the optimal selection of projects and maximize the efficiency of public spending on the roads.

Maintenance funding. The present system does not provide for adequate ongoing funding of routine and periodic maintenance of the existing network. An additional source of funding must be available for this purpose on a permanent basis.

EDUCATION SECTOR

Starting with 2000, RGC has undertaken a priority action program (PAP) aimed at the priority sectors. Education has greatly benefited from PAP allocations, which came as an additional flow of funds, mainly under Chapter 13 (special programme agreements). The treasury executed spending on education, including PAP funding, increased from 0.9 percent of GDP in 1998 to 1.5 percent of GDP in 2004. The PAP funding (Chapter 13), which was introduced in 2000, accounted for US$ 13.8 million in 2004. Most of all funds allocated to education (PAP and non-PAP) goes to funding of recurrent expenditures both at the ministerial and provincial levels.

The provincial offices have been processing the bulk of salary payments for the teachers. The corresponding Chapter 10 expenditures experienced a major increase from US$ 21.2 million in 1998 to US$ 46.2 million in 2004. The operating costs in the provinces also rose from US$ 2.2 million 1998 to US$ 4.9 million in 2004.

Capital spending at both the ministerial and provincial levels is small as compared to the size of recurrent expenditures. Funding from own resources (Chapter 50.1) rose from a mere US$ 0.1 million 1998 to US$ 2.9 million in 2001 but then again declined to US$ 0.7 million by 2004. This is explained by relatively few large-size infrastructure improvements implemented, which drive the capital budget. The same erratic pattern is observed in terms of counterpart financing (Chapter 50.2) which has fluctuated over time. It is not clear how the capital allocation relates to the PAP funding allocation.

Critical Issues

Procurement. The fiduciary risk associated with public procurement process is high due to weaknesses in the existing regulatory framework, low capacity, high informality and corruption. The same risk exists at both provincial and district levels. Also, the lack of alternative supply channels may preclude the operation of an efficient bidding system.

Institutional and Personnel Capacity. Capacity poses a major constraint on budget implementation. According to the IFAPER (WB and ADB, 2003) and PETS: Primary Education (WB, 2005), the rapid expansion of budget expenditures brought to light concerns on the capacity of officers, especially in budget preparation, costing, accounting records and reports, financial control procedures and control systems.

Infrastructure Adequacy. The issue of infrastructure adequacy arises given the large additional spending on education at all levels, and the nature of the activities where a lion's share of the budget is channeled to recurrent expenditure. The question is whether the existing school infrastructure and related maintenance funding is sufficient to keep up the pace of education improvements. It is important that the capacity of infrastructure does not eventually become a bottleneck in the system.

Supporting Facilities. As the inflow of funding increased on the sector, there is a need to provide an efficient monitoring and control of the activities undertaken with the additional funds. Despite recent improvements, office equipment and supplies, including computers and photocopiers, that are necessary for the preparation of various budget documents are inadequate at district offices and schools.

HEALTH SECTOR

The Ministry of Health (MOH) is in charge of sector planning, coordination and management. There are three main sources of funds to the sector: i) government funds, ii) external aid, and iii) private contributions. The relative importance of these sources is such that private contributions account for 72 percent of the total expenditure, foreign aid covers 19 percent, and public funding is the remaining 9 percent of the total sector spending.[2] The treasury executed spending was equal to 1.0 percent of GDP in 2003, while the external assistance was 2.0 percent of GDP. The total spending in the sector increased substantially over the period. In 1998 the MOH budget stood at US$ 12.4 million while it reached US$ 50.6 million in 2004.

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2 Policies, Expenditures and Outcome in Health Sector, Presentation to National Workshop on Integrated Fiduciary Assessment and Public Expenditure Review (WB), Cambodia, 2003.

Most of the additional funding that was given to the sector by the RGC was spent on recurrent expenditures. The government has spent very little on the health infrastructure and all the new funding under the priority action programs was directed towards personnel, medical supplies and some critical maintenance. In 2001 current expenditures reached 93 percent of the total expenditures, while over the period 1996-2004 they have always been above 96 percent, and as high as 100 percent of the total budget in 1998 and 2000. In fact, some of infrastructure spending was undertaken by donors' spending in the sector, but the question arises whether the infrastructure provision and maintenance funding have been adequate to appropriately complement the large enhancement of recurrent expenditures.

The total expenditure on salaries and allowances (Chapter 10) significantly increased both at the ministerial and provincial level. The increase in spending was even more apparent in operational costs (Chapter 11). The ministry reported that it spent US$ 7.8 million in 1998 and US$ 22.9 million in 2004, and provinces processed US$ 1.3 million in 1998 and US$ 5.0 million in 2004.

Conclusion

The large increase in funding for the health sector since 1999 has had a positive impact on the health status and indicators of the country. The question that remains whether the expenditures are being made in the most cost-effective manner. As development partners are heavily involved in the financing of many of these activities and they are being monitored very closely. However, this does not apply to the health sector expenditures being financed out of the government own resources. Given the current procurement practices, considerable scope exists for improving the allocation of expenditures through case-analysis of what are and are not effective ways of expanding the health system.

ELECTRICITY SECTOR

The undeveloped state of the electricity sector is an issue that has been identified time and time again. It is something that inhibits the growth of almost all the economic sectors. If the manufacturing exports sector is to expand rapidly it must have access to electricity at competitive prices. At the present time Cambodia has some of the highest electricity rates in the world, with retail tariffs as high as US$ 20 cent/kwh. Self generation factory by factory results in a very inefficient system for meeting the electricity needs of industry. The electricity sector needs to have a strategic plan for its efficient and effective development. This will take time, however, to carry out. In the mean time there are many investments in generation, transmission and distribution that would be compatible with any long term expansion plan and at the same time have very substantial economic and financial rates of return.

In efficient electricity system, there are many more investments in both generation and distribution where the rate of return is likely to be far above the cost of capital to the economy. While a Master Plan for the electricity system is being prepared, high return investments should be identified and implemented to strengthen and expand the existing electricity system.

3. ADMINISTRATIVE REFORM

MANUFACTURED EXPORTS AS THE FOCUS OF A STRATEGY FOR GROWTH

To reduce the incidence of poverty in a country, it must raise the value of the only resource the poor have – their labor. In the last 50 years most countries that have been successful in enabling their citizens to largely escape from poverty, have done so through the creation of jobs in the sectors manufacturing for the export markets. In a study done over 20 years ago for Indonesia (Flatters and Porter, 1984), it was found that for every dollar invested in the manufacturing exports sector the result was the creation of 4 times as many jobs and 4 times as much net value added as would be created if this same amount was invested in import substitution activities. The rapid growth of job creation in Indonesia during the period 1985 to 1990 was due primarily to a compound growth rate of manufacturing exports of more than 40 percent a year over the decade. This rapid expansion of manufactured exports followed the implementation of a comprehensive set of economic reforms in 1985 that were focused on improving the country's international competitiveness.

Cambodia has made many of the policy changes necessary for the promotion of exports. The two most important ones are the elimination of exchange controls and the exemption from import duties and domestic sales taxes of all imported inputs that are being used to manufacture exports. These are two of the most important steps a country can take when launching a policy of export lead growth.

Manufactured Exports and Poverty Eradication. The country's focus on an export-oriented growth strategy has many advantages for the poor, but at the same time some very fundamental contraints. On the positive side, exports from developing countries tend to be labour intensive. As the exporting firms expand they hire workers which tends to bid up the wage rate of such skills in the economy. In these sectors the opportunities for real cost reductions (productivity increases) are enormous, and the path to obtain these rewards are known and well laid out. The first requirement is to foster a competitive environment where entrepreneurs are rewarded for introducing cost reduction measures.

On the side of the constraints, if higher costs are imposed through either taxation or unnecessary administrative costs then the compensation paid to labor employed by these exporting firms must fall by an equal amount if the firms are to remain competitive. This comes about simply because Cambodia can neither change the international prices of the goods it sells, nor the prices of the imported inputs it buys. Furthermore, the rate of return on capital that is required by the international investors is something that Cambodia can only change by changing the level of risk investors see when considering investing in Cambodia.

Strategies for Reducing the High Cost Economy. The strategy of countries like Taiwan and Singapore has been to do everything possible to reduce the unnecessary costs borne by firms and labour in the process of conducting international trade. While in Cambodia it can take up to a week to clear imported goods and sometimes export goods from Customs, with average time measured in days. In Taiwan and Singapore the average clearing times are measured in minutes with major delays measured in hours.[3] In countries, like Cambodia today, where the systems creating the unnecesary costs and delays in importing and exporting are deeply rooted and politically difficult to reform, a strategy should be followed to create new systems that are designed to service the export sector and operate in parallel for a period with the existing system that is used for other types of imports.

FREE TRADE ZONES

The proposal to develop one or more special economic zones in Cambodia that are dedicated to firms engaged in manufactured exports is an idea that is worthy of support. There are a number of issues, however, that need to be considered carefully in the design of rules governing these facilities. In general the proposals below are designed to allow in the future an easy integration of the SEZs into the rest of the economy:

1. The present exemption from import tariffs, VAT and other indirect taxes of all imported goods to be used in the manufacture of exports should be continued for all operations in the special economic zones.
2. The One-Stop-Shop system should be implemented to reduce the need for the exporters to have to deal with a large number of government officials in order to process the paper work. There should be a single agency, located close to the factories in the zone that can deal with all the adminstrative worked associated with the imports, and export functions of the factories.
3. An accounts-based suspension system should be used to administer this duty and tax suspension system. We would recomment that no bank guarantee or bond be required for exporters who have a track record of performance (two or three shipments).
4. The firms in the special economic zones should be allowed to make sales into the domestic economy if they pay all the import duties that would otherwise have been paid on their inputs if they had been operating in the rest of the domestic economy.
5. The firms operating in the SEZ should be allowed to sell into the domestic economy but should be subject to the full rate of VAT on the sales price of the items. No VAT input tax credits should be allowed as a deduction from the amount of VAT owed on sales into the domestic economy.

Implications for Government Expenditures. These changes will all require public sector expenditures to be made to implement them and under most circumstances to operate them in the future. Given the experience of countries mentioned above, there is likely to be no other government exenditure would have as high a rate of return at the present time as would investments in the technology, institutions and infrastructure needed to create an efficient international trade management system for Cambodia. The reduction in compliance costs immediately brings about higher returns to the private sector investments. Throught the expansion of the private sector as a response to the higher rates of return there will be a better

[3] Jenkins, Glenn, *Taxation and Development in Taiwan*, (with CY Kuo and KN Sun), Harvard Studies in International Development, Harvard University Press, Cambridge MA, 2003.

utilization and higher economic returns arising from the public sector infrastructure that is used by to the private sector activities.

PUBLIC SECTOR INVESTMENT PREPARATION UNIT

At the present time Government of Cambodia lacks the institutional capacity to identify, appraise and prepare for funding a portfolio of potentially high return projects in the public sector. It is proposed that the country start immediately to build up the skills within the public sector in the area of public sector investment appraisal. It is the private sector who is the ultimate beneficiaries of the high economic return infrastructure and social investments that such a professional process of capital expenditure selection and implementation helps to realize.

The successful experiences of the Public Sector Investment Appraisal System in Chile, and the Economic Planning Unit of Malaysia highlight the importance of developing the capacity within the government of professionally evaluating the options it faces in the area of capital expenditures. If public sector investment decision-making is simply demand driven by the political process of the country, then it is likely that several low return projects where a small number of beneficiaries, each benefiting a substantial amount, will get selected, but to the detriment of the rest of society.

4. CONCLUSION

It is recommended that as additional funds become available the government should allocate them to high return investment projects in the areas of roads, electricity and trade facilitation. In addition, the agriculture sector should be given a priority focus in terms of planning and practical coordination of activities and investments undertaken by MAFF and MRWM if the reduction of poverty is to be achieved in the country.

The agriculture, forestry, fisheries sectors produce the income on which about 80 percent of the country’s population depend for survival. Because it is a sector where investment projects in infrastructure are difficult to implement, it has been neglected. However, if poverty is to be addressed in Cambodia, then initially it is the rural poor whose income must be raised. The most important constraint to investment in this sector, it the lack of a strategic plan that clearly identifies the priority actions and areas that should be addressed. Priorities need to be set for both infrastructure in irrigation and rural roads. Of immediate concern is the difficulty facing the farmer is the lack of availability and high cost of agricultural inputs such as seeds and fertilizer. This is followed by a poor irrigation infrastructure and extension services. In addition, the weak legal and regulatory framework, particularly concerning land ownership, is causing unnecessary risks to investments in the sector. These issues need to be addressed as quickly as possible if Cambodia’s rural poor are to escape from their present living conditions. However, a prerequisite for undertaking capital expenditures in the agricultural must be a strategic plan that clearly sets out priorities for achieving real progress in raising the incomes of those living in the rural areas.

The roads sector that serves all other sectors of the economy currently suffers from a number of deficiencies including lack of technical involvement in roads planning and management; limited maintenance funding and coordination; absence of transparent project selection system; and inefficient contracting and procurement. This is a sector that will need to have heavy donor involvement for some time to come. It is also a sector where a modest investment in developing project selection and appraisal skills within the Ministries would have very high returns. The government will need to allocate considerable more money than it is now allocating toward road maintenance if the services from the investments made using donor funding is to be achieved.

The private sector has assisted to a considerable extent in improving the electricity service in Cambodia. However, there are many things in terms of system reliability and system expansion which would greatly improve the service to its existing consumers. In addition, such electricity system improvements would go a long way to improving the climate for foreign investors to come to climate the investment climate of Cambodia.

In the area of administrative reform, new systems must be introduced in the management of international trade in commodities that will reduce the compliance costs associated with both the importation or exporting of manufactured goods and commodities. From the study of other countries with systems that were not as bad as Cambodia's the rates of return from investments made to modernize customs, ports, and tax administrations are in the hundreds of percent rate of return. Cambodia has been able to attract a large number of garment factories, and it is still attracting them. With this experience it is only natural to graduate from garment production to the manufacture of other goods. With the private sector willing to respond to improvements in the incentives they face, the government should be willing to make the necessary expenditures to implement and operate a world class trade and port administration systems. This is an area where no developing country can isolate itself and opt for second class status. High transactions costs with respect to international trade simply lower the wages that these international firms are willing to pay to their workers. Hence, the burden of such transactions costs will fall entirely and more than fully on labor.

In order to improve the resource allocation done through the government budget, a critical mass of government officials need to be trained in project preparation and appraisal. In an environment of weak governance the potential for selecting investment projects or undertaking programs that have a very low rates of return are very high. There is a need to build the professional skills that enable the public officials to be able to reject proposals that are going to lead to a waste of economic resources, so that the scarce funds can be spent on high return activities.

EXPENDITURE POLICY TO PROMOTE GROWTH: CAMBODIA

1. INTRODUCTION

Since the time Cambodia emerged from the decades-long civil war the country has faced a number of major challenges in almost every aspect of social and political life. The main achievement has been the ability of the government to maintain the peace and to create an acceptable level of security throughout the country. This has allowed the private sector and international investors to resume operations and to give the current generation of Cambodians hope for a better life. The international community has been active in assisting in this transition from a militarized state into a market economy.

The government, with the help of development partners, has made progress in the rehabilitation of the basic infrastructure in water, sanitation and road sectors, and in the provision of essential services in the health and education sectors. On the industrial side, a true success story has been the development of a significant garment manufacturing sector, which has been the key element behind the growth of the economy in recent years. At this point in time, the government and its development partners are working to spread the growth to other sectors of the economy.

1. Objectives of Study. The objectives of this study are to identify the most important constraints to achieving higher rates of pro-poor growth in Cambodia, and to propose some public sector expenditure policies that might address these constraints.

The approach taken in this study is to look at the objectives, size, composition, and financing of government expenditures since the late 1990s to the present time. The study then examines a selection of recent investment projects undertaken in the key sectors of Cambodian economy with a view toward learning from past experience what is likely to be the areas where highly productive investments have been made. A set of recommendations are made to adjust the policy framework so that public sector spending might be redirected to enhance both the growth and poverty eradication objectives of the country.

2. Background. Cambodia is a low income country of 13 millions souls that has been deprived of both human and physical capital. In such a situation it is easy to identify public sector opportunities for both current expenditure and investment activities that are in great demand and highly productive. The challenge is to determine the expenditure activities that the public sector is able to implement and manage in a way that will effectively address these needs. A further policy question is what should be the balance between public investments in physical infrastructure and investments in the foundations of human capital - health and education. By every development indicator Cambodia is behind all the countries in the region, except Laos and Myanmar. Over the decade between 1994 and 2003, it has experienced an average annual real growth rates of approximately 6 percent, but from a very low level of income.[4]

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[4] Asian Development Bank (2005), Connecting East Asia: A New Framework for Infrastructure, pg 2.

There are three problems facing Cambodia that we take up in this paper that public sector expenditure policies in the next years should address. First, there is a high incidence of poverty, particularly in the rural areas (90 percent of the poor), with at least 4 million in 2000 falling below the poverty line.[5] Much of this poverty is caused by the lack of food security. Second, the system of public administration is weak. Third, the amount and quality of the infrastructure is very low outside of the main cities.

While there is no simple way to eradicate poverty, Cambodia has a number of fundamental advantages that facilitate the reduction of poverty. The country is blessed with good soils, ample water supplies (although not developed), access to the sea, and is located in a region of the world that is growing rapidly.[6] Policy makers do not have to look very far to find examples of economic policies that work.

The poor quality of governance is an issue that is raised in almost every report and discussion of the Cambodian economy. It manifests itself in the epidemic levels of corruption practiced my many in the public administration, great uncertainty with respect to property rights, and a weak system of justice. At the same time policy makers have chosen the path of economic development that emphasizes openness to international trade and investment as being the fundamental economic framework for bringing economic progress to the country. While it may appear initially that the chosen development strategy is not consistent with the state of governance in the country, in fact it is the demands of those stakeholders trying to do business in an internationally open country that are the strongest catalyst for improving the state of governance. From its history, both in times of conflict and peace, there is no institutional memory in Cambodia of a time of when good governance was the norm. It is the local and foreign business community as they try to export from Cambodia into an internationally competitive market that puts the spotlight on the institutional and infrastructural weaknesses of the country. It is the outward looking business community that defines the standards the country must achieve in order to be internationally competitive.

Cambodia's history of violence resulted in a breakdown of the infrastructure that it needs to function efficiently. Although some progress is being made, the roads, electricity, and irrigation-drainage systems are still in poor shape.[7] The absence of such infrastructure is a serious impediment to achieving progress on poverty eradication, either through the growth of productivity in the agricultural sector or by employment creation through the expansion of manufactured exports.[8]

For the agricultural sector to grow it must have better access to markets and the technology that will increase productivity. In the context of Cambodia, this means better secondary and tertiary roads, access to irrigated land, and improved inputs. The studies on the impact of

[5] Stephen Jones (2004), Background Paper: Contribution of Infrastructure to Growth and Poverty Reduction in East Asia and the Pacific, Oxford Policy Management, pg. 27-30. Here poverty is defined as having an income of less than US$1/day.

[6] Cambodochine Dao, (May 2005) New Sources of Growth, Trade and Poverty, pg. 5.

[7] World Bank (2005), Cambodia Rural Sector Strategy Note: Towards a Strategy for Rural Growth and Poverty Reduction.

[8] World Bank (2004), Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy for Cambodia, pg. 26-28.

infrastructure on poverty have found conclusively that as infrastructure services are improved the incidence of poverty is reduced.[9] Calderon and Serven (2004) completed the most comprehensive empirical analysis to date of these issues. They found that the quantity and quality of the infrastructure in a country had a positive effect on long run economic growth, and also it had a negative impact on income inequality. In China and India rural roads have the largest measurable impact on levels of poverty. For Indonesia (Kwon, 2000) found that the poverty impact of economic growth was almost four time higher in provinces with high levels of road provision compared to those with poor levels.

Infrastructure and technical services in the rural sector lower the cost of production and delivery of agriculture commodities, hence, making it possible for the farmers to increase their net income. An adequate level of infrastructure services in the manufacturing sector, usually electricity, water, and roads, provides an incentive to invest, hence increasing employment and wages, while reducing the incidence of poverty. Excessive compliance costs caused by a weak government administration have the opposite impact, raising costs, reducing investment, reducing employment and increasing poverty.

Infrastructure investments, particularly those that made in the rural areas, are usually planned and financed by governments. The challenge is find ways for the private sector, who may be the beneficiaries of the infrastructure, to participate in the management and maintenance of these facilities so that their potential contribution to growth and the eradication of poverty can be realized.

From the analysis of public sector expenditures since 1998 it is clear that the government has been successful at reducing expenditures on the military and security, while expanding outlays on health and education. At the same time, the public sector's expenditures on capital investments that are internally financed have been very small. The challenge is to see if the government can adequately maintain the capital expenditures on such things as roads that have been externally financed.

3. Overview of Recommendations. It is recommended that as additional funds become available the government should allocate them to high return investment projects in the areas of roads, electricity and trade facilitation. In addition, the agriculture sector should be given a priority focus if the reduction of poverty is to be achieved.

The agriculture, forestry, fisheries sectors produce the income on which about 80 percent of the country's population depend for survival. Because it is a sector where investment projects in infrastructure are difficult to implement, it has been neglected. However, if poverty is to be addressed in Cambodia, then initially it is the rural poor whose income must be raised. The most important constraint to investment in this sector, is the lack of a strategic plan that clearly identifies the priority actions and areas that should be addressed. Priorities need to be set for both infrastructure in irrigation and rural roads. Of immediate concern is the difficulty facing the farmer is the lack of availability and high cost of agricultural inputs such as seeds and fertilizer. This is followed by a poor irrigation infrastructure and extension services. In addition, the weak legal and regulatory framework, particularly concerning land ownership, is

9 Calderon and Serven (2004); Willoughby (2002) and Easterly and Rebelo (2004); Estache and Fay (1995).

causing unnecessary risks to investments in the sector. These issues need to be addressed as quickly as possible if Cambodia's rural poor escape from their present living conditions. However, a prerequisite for undertaking capital expenditures in the agricultural must be a strategic plan that clearly sets out priorities for achieving real progress in raising the incomes of those living in the rural areas.

The roads sector that serves all other sectors of the economy currently suffers from a number of deficiencies including lack of technical involvement in roads planning and management; limited maintenance funding and coordination; absence of transparent project selection system; and inefficient contracting and procurement. This is a sector that will need to have heavy donor involvement for some time to come. It is also a sector where a modest investment in developing project selection and appraisal skills within the Ministries would have very high returns. The government will need to allocate considerable more money than it is now allocating toward road maintenance if the services from the investments made using donor funding is to be achieved.

The private sector has assisted to a considerable extent in improving the electricity service in Cambodia. However, there are many things in terms of system reliability and system expansion which would greatly improve the service to its existing consumers. In addition, such electricity system improvements would go a long way to improving the climate for foreign investment in Cambodia.

In the area of administrative reform, new systems must be introduced in the management of international trade in commodities that will reduce the compliance costs associated with either the importation or exporting of manufactured goods and commodities. From the study of other countries with systems that were not as bad as Cambodia's the rates of return from investments made to modernize customs, ports, and tax administrations are in the hundreds of percent rate of return. Cambodia has been able to attract a large number of garment factories, and it is still attracting them. With this experience it is only natural to graduate from garment production to the manufacture of other goods. With the private sector willing to respond to improvements in the incentives they face, the government should be willing to make the necessary expenditures to implement and operate a world class trade and port administration systems. This is an area that no developing country can isolate itself and opt for second class status. High transactions costs with respect international trade simply lower the wages that these international firms are willing to pay to their workers. Hence, the burden of such transactions costs will fall entirely and more than fully on labor.

In order to improve the resource allocation done through the government budget, a critical mass of government officials need to be trained in project preparation and appraisal. In an environment of weak governance the potential for selecting investment projects or undertaking programs that have a very low rates of return are very high. There is a need to build the professional skills that enable the public officials to be able to reject proposals that are going to lead to a waste of economic resources, so that the scarce funds can be spent on high return activities.

2. EXPENDITURE ALLOCATION

TRENDS IN PUBLIC SPENDING

1. **Size of Public Expenditure**. The size of public expenditure, broadly defined and including external assistance financed projects, humanitarian aid, and treasury-executed expenditures, as shown in Table 2.1 slightly declined from 23.0 percent of GDP in 1998, but has since been rising to 25.3 percent in 2002 and 24.6 percent in 2003. Treasury executed expenditures include expenditures financed from internal government resources (revenues) as well as expenditures co-financed by development partners. Annex A contains the definition of each sector. The size of the treasury-executed component, of government expenditure is shown in Table 2.2. Over the past decade this component of total public sector spending has moved with a general rising trend in a highly irregular pattern within a range 9.0 to 12.9 percent of GDP.

Table 2.1: Government and Externally Financed Expenditure by Summary Function, 1996-2003 (% GDP)

Summary Function	1996	1997	1998	1999	2000	2001	2002	2003
Core Government	**10.7**	**8.7**	**9.4**	**7.2**	**8.4**	**7.7**	**8.8**	**7.4**
Economic Services	**5.9**	**4.3**	**4.4**	**4.2**	**4.5**	**4.5**	**5.4**	**5.0**
Agriculture	2.1	0.8	0.6	0.9	1.5	1.3	1.3	1.3
Transport	2.0	1.5	1.7	1.2	1.8	2.2	2.8	2.2
Other Economic Services	1.6	1.9	2.0	2.0	1.1	0.9	0.9	1.0
Environmental Protection	0.1	0.2	0.1	0.1	0.1	0.1	0.4	0.5
Rural Development	**2.3**	**2.0**	**2.1**	**1.8**	**1.9**	**1.8**	**1.6**	**1.5**
Social Services	**4.8**	**4.9**	**6.7**	**6.5**	**6.7**	**7.6**	**8.2**	**8.4**
Health	1.7	1.5	2.4	3.0	2.6	2.5	2.6	3.0
Education	1.9	2.3	2.7	2.3	2.3	2.6	3.3	3.3
Community & Social Services	1.1	1.1	1.5	1.3	1.8	2.6	2.3	2.2
Humanitarian Aid & Relief	**1.0**	**0.6**	**0.5**	**1.7**	**2.1**	**1.3**	**1.3**	**2.2**
Total	**24.6**	**20.5**	**23.0**	**21.3**	**23.6**	**22.8**	**25.3**	**24.6**
Of which Treasury Executed	**9.8**	**9.2**	**9.0**	**9.9**	**10.9**	**11.0**	**12.9**	**12.7**
Share of Treasury Executed	0.43	0.45	0.39	0.47	0.46	0.48	0.51	0.52
Share of External Financing	0.57	0.55	0.61	0.53	0.54	0.52	0.49	0.48

Source: Based on World Bank estimates, CDC Database and MEF TOFE.

Most of external assistance has been provided directly to the executing agencies, bypassing the Treasury. Such resource allocations are not adequately reflected in the planning and reporting documents of the government, and as a result it is very difficult to accurately aggregate the information on the donors' spending in the country. At the moment, the Development Cooperation Report, produced by the Council for Development of Cambodia, is the only comprehensive quantitative survey of donors' assistance in the country, but the compilation of the data for 2004 and 2005 has not been completed.

The information in Table 2.1 is the aggregated amounts of the public expenditures that are executed by the government (although some expenditures might be foreign financed) plus the foreign financed projects that are not executed by the government. In Table 2.2 the information for the public sector expenditures that are exclusively executed by the government are presented. From this information we can see that the size of the Core Government has been steadily declining since 2000 from 6.4 percent of GDP in that year to 3.7 percent in the budget of 2005. At the same time, since 2001 the level of social sector expenditures on health, education, and community and social services has only marginally increased to 3.2 percent of GDP by 2004.

Table 2.2: Government Executed Expenditure by Summary Function, 1996-2003 (% GDP)

Summary Function	1996	1997	1998	1999	2000	2001	2002	2003	2004*	2005B*
Core Government	**6.1**	**5.8**	**6.3**	**5.4**	**6.4**	**5.6**	**6.0**	**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 Services	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	0.0	0.0	0.0	0.0	0.0
Rural Development	**0.1**	**0.0**	**0.1**	**0.1**	**0.1**	**0.2**	**0.4**	**0.5**	**0.4**	**0.3**
Social Services	**1.9**	**2.0**	**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	1.0	1.0	0.9	1.0
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 Aid & Relief	**0.6**	**0.1**	**0.2**	**0.4**	**0.3**	**0.2**	**1.0**	**1.8**	**0.8**	**1.9**
Total	**9.8**	**9.2**	**9.0**	**9.9**	**10.9**	**11.0**	**12.9**	**12.7**	**10.1**	**10.1**
Share of Total (Government plus External)	0.43	0.45	0.39	0.47	0.46	0.48	0.51	0.52	n/a	n/a

Source: Based on World Bank estimates and MEF TOFE.
*Note: * Only government expenditures are presented for 2004 and 2005. The reported figures for year 2005 are budget plans.*

The data on the volume of external assistance is scattered across a number of donor agencies operating in Cambodia, hence the figures for 2004 and 2005 have not yet been consolidated. Considering the period 1996 to 2003 the international assistance has remained high, flowing at a rate of 14.9 percent or GDP in 1996 and declining to a lower rate of 11.9 percent of GDP by 2003.

While the overall size of public spending in Cambodia is higher than in other low income countries of the region, according to Table 2.4, this indicator should be taken with a caution since, at least, 48 percent of the total public sector expenditure is externally financed in 2003 as reported in Table 2.3. The donor agencies has played a much more important role in the financing and executing of typical public sector expenditures in Cambodia than is found in any neighboring country of a similar per capita income.

Table 2.3: Externally Financed and Executed Expenditures by Summary Function, 1996-2003 (% GDP)

Summary Function	1996	1997	1998	1999	2000	2001	2002	2003
Core Government	**4.6**	**2.9**	**3.1**	**1.7**	**2.0**	**2.1**	**2.8**	**2.0**
Economic Services	**4.8**	**3.0**	**3.6**	**2.8**	**3.2**	**2.6**	**3.3**	**3.4**
Agriculture	1.9	0.5	0.4	0.7	1.2	0.9	0.9	0.9
Transport	1.7	1.1	1.5	1.0	1.3	1.5	1.9	1.6
Other Economic Services	1.1	1.2	1.5	1.0	0.6	0.2	0.2	0.5
Environmental Protection	0.1	0.2	0.1	0.1	0.1	0.0	0.4	0.5
Rural Development	**2.2**	**2.0**	**2.0**	**1.7**	**1.8**	**1.6**	**1.2**	**1.1**
Social Services	**2.9**	**2.9**	**5.0**	**3.9**	**4.0**	**4.6**	**4.8**	**5.0**
Health	1.3	0.9	2.0	2.0	1.9	1.7	1.6	2.0
Education	1.0	1.4	1.9	1.2	1.1	1.1	1.6	1.7
Community & Social Services	0.6	0.6	1.1	0.7	1.0	1.8	1.5	1.3
Humanitarian Aid & Relief	**0.4**	**0.5**	**0.3**	**1.3**	**1.8**	**1.0**	**0.3**	**0.4**
Total	**14.9**	**11.3**	**14.0**	**11.4**	**12.8**	**11.9**	**12.4**	**11.9**
Share of Externally Financed	0.57	0.55	0.61	0.53	0.54	0.52	0.49	0.48

Source: CDC Database (2003).

This has been particularly the case for social services (health, education and community services) where in Table 2.3 we find that the amount of foreign financed expenditures between the years 1998 and 2003 averaged annual 4.6 percent of GDP. Combining the foreign financed and executed expenditures with the amounts that were spent by the government on behalf of social services we find that the total comes to an annual average public sector expenditure of 7.4 percent of GDP over the period of 1998-2003.

Table 2.4: Public Expenditure in Cambodia and International Comparison (% GDP)

Comparators	Total*	Health	Education
East Asia & Pacific 2001	15.0	1.8	4.0
South Asia 2001	16.7	1.2	3.0
Low Income 2001	18.4	1.2	3.8
Vietnam 2002	21.2	1.5	2.8
Lao PDR 2002	n/a	1.5	2.4
Cambodia, incl. External 2003	22.0	3.0	3.3
Cambodia, Government only 2003	13.4	1.0	1.4

Source: World Development Indicators, 2003.
*Note: * The public expenditures shown here for the other countries, include the expenditures financed by international associations.*

Table 2.5 provides us with some information to carry out a comparative analysis of Cambodia's situation with its neighbors and countries in the region that have similar characteristics. The comparison is made with Vietnam, Thailand, Indonesia, China and India. According to the reported indicators, Cambodia is the leading recipient of international aid, receiving as much as 48.0 percent of the central government expenditures. Vietnam and India, while being in the same per-capita income group, receive external aid for only 16.2 and 2.1 percent of the central government expenditures, respectively. At the moment, Cambodia has the lowest life expectancy in the sample. A significant effort has been undertaken to improve the healthcare in the country, which is reflected in the size of public spending on health (government own resources plus external assistance). The RGC spent a total of 3.0 percent of GDP on the public healthcare in 2003, as shown in Table 2.4. This is more than in any other country in the region. But two thirds of that spending was financed from external aid. Due to data availability the information presented in this table is for the period from 1999 to 2004. We have the most recent indicators for Cambodia, relative to other countries, in order to avoid any bias in comparison.

Table 2.5: Development Indicators (year 2002 unless stated otherwise)

	Cambodia	Vietnam	Thailand	Indonesia	China	India
Aid (% of central government expenditures)	48.0 ^{2003}	16.2	1.2 ^{2001}	4.3 ^{2001}	n/a	2.1 ^{2001}
GNI per capita (current $ 2003)	300.0	480.0	2190.0	810.0	1100.0	493.3
Health expenditure, public (% of GDP) [10]	3.0 ^{2003}	1.5 ^{2001}	2.1 ^{2001}	0.6 ^{2001}	2.0 ^{2001}	0.9 ^{2001}
Life expectancy at birth, total (years)	54.0	69.7	69.2	66.7	70.7	63.4
Education expenditure, public (% of GDP) [11]	3.3 ^{2003}	3.0	4.0 ^{2003}	0.8 ^{2001}	0.2 ^{2001}	0.4 ^{2003}
Pupil-teacher ratio, primary	56.3 ^{2001}	26.3 ^{2001}	19.1 ^{2001}	20.9 ^{2001}	19.6 ^{2000}	40.1 ^{2000}
Rural population (% of total population)	82.0	75.1	79.8	57.0	62.4	71.9
Electric power consumption (kwh per capita)	80 ^{2004}	325.2 ^{2001}	1,508.4 ^{2001}	404.4 ^{2001}	893.4 ^{2001}	364.7 ^{2001}
Roads, paved (% of total roads)	16.2 ^{2001}	25.1 ^{1999}	98.5 ^{2001}	46.3 ^{1999}	91.0 ^{1999}	45.7 ^{1999}

Source: World Development Indicators, World Bank, 2004.

The overall spending on education by the government and donors has also been increased in the recent years. Referring back to Table 2.4, one could see that the total public spending was 3.3 percent of GDP, which is comparable to Vietnam and Laos. If only the government budget is considered, this indicator would be 1.4 percent of GDP. This is two-thirds of the average education spending of other low income and East Asia & Pacific countries. The addition of external financing brings the total spending on education to 3.3 percent of GDP. This is still below the level of education spending in the neighbor countries, except Laos. This observation is confirmed by the magnitude of the pupil-teacher ratio in primary schools in Table 2.5, where Cambodia has more than twice the number of learners per teacher than Vietnam, Thailand, Indonesia or China.

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[10] Public expenditure on health consists of recurrent and capital spending from government (central and local) budgets, external borrowings and grants (including donations from international agencies and nongovernmental organizations), and social (or compulsory) health insurance funds.

[11] Public expenditure on education consists of public spending on public education plus subsidies to private education at the primary, secondary, and tertiary levels.

Cambodia is predominantly a rural country, with more than 80 percent of population living in rural areas. The country's surface is covered with lakes, rivers and tropical forests, which in the conjunction with the old dilapidated electricity infrastructure and scattered demand makes it difficult to bring reliable and affordable electric power to the people. The estimated per capital electricity consumption in Cambodia is one of the lowest in the world, about 80 kwh a year. This is approximately 20 percent of Indonesia's per capital electricity consumption or 25 percent of that of Vietnam. This extremely low rate of consumption is the result of unfortunate circumstances: an insufficient and expensive generation system, an old and unreliable distribution and transmission network, and a lack of interconnection between domestic demand and generation centers.

The roads infrastructure is also inadequate in terms of the requirements of a development economy because less than quarter of the total roads network is paved in Cambodia. In comparison, Vietnam and Indonesia have 25.1 and 46.3 percent of their total roads paved, respectively.

2. Spending in Priority Sectors. The RGC has chosen education, health, agriculture and rural development as priority development sectors and adopted a series of measures aimed at boosting the economic activity in these fields. Over a period from 1998 to 2001, a sharp increase in Government's spending was witnessed in these sectors, as Table 2.6 suggests. Over the same period, the spending on general administration and judiciary also has risen substantially. At the same time, the RGC managed to cut spending on defense and security. Expressed as a share of GDP, the government's involvement in economic services, rural development, and social services doubled from 2.6 percent of GDP in 1998 to 5.1 percent in 2001. The overall rise in Treasury spending was 21.2 percent, from 9.0 percent of GDP in 1998 to 11.0 percent in 2001.

Over the next period from 2001 to 2004, the size of government expenditures has fluctuated. The overall size of Treasury spending relative to GDP initially rose from 11.0 percent of GDP in 2001 to 12.9 and 12.7 percent in 2002 and 2003, and then fell to 10.1 percent by 2004. The total spending on core government functions was, on the average, 5.9 percent of GDP over 1998-2001, and 5.3 percent over 2001-04. The defense and security spending declined from an average of 2.3 and 1.0 percent of GDP, respectively, during 1998-2001, to levels of 1.4 and 0.8 percent of GDP during 2001-04. At the same time, the cost of general administration rose from 2.5 percent of GDP over 1998-2001, to 2.8 percent over 2001-04. From these trends in expenditures, it is clear that the government has been quite successful in reducing the burden of the core government administration and defense relative to GDP. If one compares the values of these expenditures in the years 2000-01 with the situation in 2005, one finds that the government has been able to reallocate approximately 2 percent of its expenditures away from defense and security. This is a very significant achievement for a government in almost under any circumstance. However the question remains whether this reduction in expenditures for general administration has been offset to the same degree by an increase of rent-seeking behavior by the bureaucracy to recapture these funds.

Spending on economic services averaged 1.4 percent of GDP over 1998-2001, and slightly increased to 1.6 percent over 2001-04. Rural development funding was substantially increased. The average spending over the period of 1998-2001 was only 0.1 percent of GDP and was increased to 0.4 percent over the 2001-04 period. The expenditures on social services were also raised. Over the period of 1998-2001 it was 2.5 percent of GDP, on the average, and then was enlarged to 3.4 percent over 2001-04. This increase was shared between education and healthcare. As mentioned above, these expenditures have been heavily augmented by donor financed projects amounting to 3.7 percent of GDP by 2003.

Table 2.6: Treasury-Executed Spending by Function, 1996-2005 (% of GDP)

Function	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005B	Average 1998-01	Average 2001-04
Core Government	**6.1**	**5.8**	**6.3**	**5.4**	**6.4**	**5.6**	**6.0**	**5.5**	**4.5**	**3.7**	**5.9**	**5.3**
General Administration	1.7	1.4	2.4	1.9	3.2	2.8	2.9	3.1	2.4	1.9	2.5	2.8
Defense	3.2	3.0	2.7	2.5	2.2	1.8	1.6	1.5	1.3	1.1	2.3	1.4
Security	1.2	1.3	1.2	1.0	1.0	0.9	0.9	0.8	0.8	0.6	1.0	0.8
Judiciary	0.0	0.0	0.0	0.0	0.0	0.0	0.7	0.1	0.0	0.1	0.0	0.3
Economic Services	**1.1**	**1.3**	**0.8**	**1.4**	**1.4**	**1.8**	**2.1**	**1.6**	**1.2**	**1.3**	**1.4**	**1.6**
Agriculture	0.2	0.2	0.2	0.2	0.3	0.4	0.4	0.4	0.3	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	0.4	0.7
Public Works	0.3	0.2	0.1	0.2	0.5	0.6	0.9	0.6	0.5	0.4	0.4	0.7
Other Transport	0.0	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.0
Other Economic Services	0.5	0.7	0.5	0.9	0.5	0.7	0.7	0.5	0.3	0.4	0.7	0.5
Environmental Protection	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rural Development	**0.1**	**0.0**	**0.1**	**0.1**	**0.1**	**0.2**	**0.4**	**0.5**	**0.4**	**0.3**	**0.1**	**0.4**
Social Services	**1.9**	**2.0**	**1.7**	**2.6**	**2.7**	**3.1**	**3.5**	**3.4**	**3.2**	**2.9**	**2.5**	**3.4**
Health	0.5	0.5	0.4	0.9	0.7	0.9	1.0	1.0	0.9	1.0	0.7	1.0
Recreation, Culture & Religion	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.2
Education	0.9	0.8	0.9	1.1	1.2	1.4	1.7	1.6	1.5	1.4	1.1	1.6
Social Protection	0.5	0.5	0.4	0.5	0.6	0.6	0.6	0.6	0.6	0.4	0.5	0.6
Other	**0.6**	**0.1**	**0.2**	**0.4**	**0.3**	**0.2**	**1.0**	**1.8**	**0.8**	**1.9**	**0.3**	**1.2**
Debt	0.6	0.1	0.2	0.2	0.2	0.2	0.2	0.8	0.4	0.6	0.2	0.5
Capital Expenditure *	-	-	-	-	-	-	0.6	0.7	0.3	0.8	-	0.6
Other not classified	-	-	-	0.1	0.1	0.1	0.1	0.2	0.1	0.6	0.1	0.1
Total	**9.8**	**9.2**	**9.0**	**9.9**	**10.9**	**11.0**	**12.9**	**12.7**	**10.1**	**10.1**	**10.2**	**11.9**

Source: Based on World Bank estimates, CDC Database and MEF TOFE.
*Note: * The way government budget expenditures are reported was changed in 2001. Until that period, all capital expenditures were reported under the corresponding ministry. Thereafter, the mechanism was adjusted so that some of the capital expenditures that were reported by the government were not allocated across the ministries and the remainder is presented separately.*

In terms of absolute figures, the size of public expenditures on economic activities and rural development programs remains very small compared to spending on other sectors. In 2004, the core government services and social services were allocated 4.5 and 3.2 percent of GDP, respectively. At the same time, economic services and rural development had only 1.2 and 0.4 percent of GDP, respectively.

Table 2.7 presents the treasury-executed spending by function over the period 1996-2005. Core government expenditures declined from 69.4 percent of the budget in 1998 to 44.6 percent in 2004. This has allowed the Government to augment the delivery of social services from 18.8 percent of the budget in 1998 to 31.7 percent of the budget in 2004. In regard to funding of economic services, there was an upward trend over a period 1998-2001 with a peak of 16.9 percent of the budget allocation in 2001, and then there has been a phase of spending cuts over 2001-2004. The agriculture sector has also been affected negatively by this trend, but the 2005 budget plans to restore the share of agriculture to 4.1 percent of the overall spending. However, as compared to spending on the social sectors, little is being spent on public expenditures for the agricultural sector.

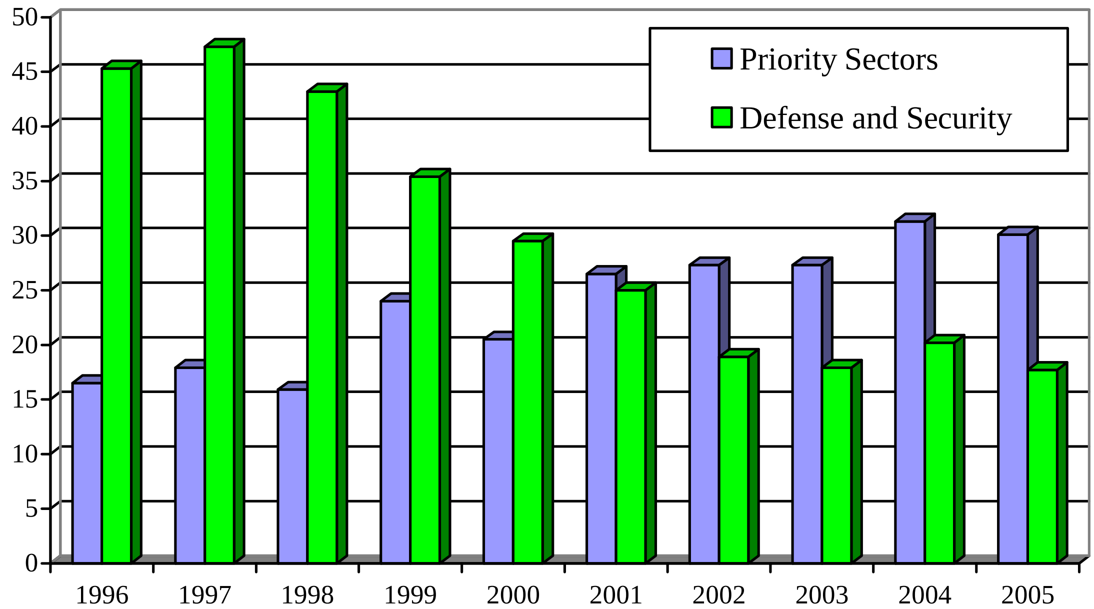
Table 2.7: Treasury-Executed Spending by Function, 1996-2005 (% of Structure)

Function	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005B
Core Government	**62.6**	**63.2**	**69.4**	**54.7**	**58.9**	**51.0**	**46.6**	**43.0**	**44.6**	**36.7**
General Administration	17.0	15.7	26.0	19.0	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**	**16.0**	**12.9**	**12.2**	**13.0**
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	5.0	5.4	4.7
Public Works	2.6	2.6	1.2	2.2	4.7	5.4	7.0	4.6	5.1	4.3
Other Transport	0.5	1.5	0.5	0.4	0.4	1.0	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**	**3.0**	**3.6**	**3.8**	**2.7**
Social Services	**19.5**	**21.2**	**18.8**	**26.4**	**24.8**	**28.1**	**27.0**	**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	5.0	5.5	4.6	4.8	5.7	5.4	4.5	5.0	6.1	4.1
Other	**6.5**	**1.0**	**1.9**	**3.5**	**2.9**	**2.2**	**7.5**	**13.8**	**7.7**	**18.9**
Debt	6.5	1.0	1.9	2.5	2.0	1.8	1.7	6.5	3.9	5.5
Capital Expenditure	-	-	-	-	-	-	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	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: MEF TOFE Reports.

The total spending on the priority sectors in Cambodia has often been compared to the size of the combined defense and security funding. Figure 1 shows the two flows over the period from 1996 to 2005. There is a clear achievement of the government in terms of cutting the defense and security spending in favor of civilian use, specifically the priority sectors. In 1998, the size of defense and security budget was 43.2 percent of the budget while the priority sectors spending accounted for only 15.9 percent. In contrast, the 2004 actual budget spending was allocated in such a way that the priority sectors received 31.3 percent of the budget while defense and security had only 20.2 percent. This trend is expected to continue into 2005, and the plans are that the priority sector funding will be 30.1 percent, while defense and spending will be further reduced to 17.7 percent of the budget.

Figure 2.1: Treasury-Executed Spending on Priority Sectors vs. Defense and Security, 1996-2005 (% of Structure)



Annex B presents the budget allocation by function over a period of 1996-2005 in constant 2005 prices. The combined spending on defense and security needs was US$ 130.8 million in 1996, and only US$ 47.6 million was allocated among agriculture, rural development, health and education. By 1998, the actual spending on defense and security was cut to US$ 128.0 million but, the priority sector funding was only US$ 47.2 million. Since that time the situation has changed radically. By 2001 the defense and security had a combined budget of only US$ 117.8 million, while the priority sectors were given a total of US$ 125.2 million, exceeding the defense/security budget for the first time. This trend has remained its pace until year 2004, when the budget allocation was US$ 112.0 million for defense/security and US$ 173.4 million for the priority sectors. It is expected that the budget for the priority sectors will reach US$ 188.1 million by 2005.

Agriculture, transport, public works, and rural development seem to be grossly under funded. By 2004, the combined budget for all economic services and rural development was only US$ 88.5 million in constant 2005 prices. The level of debt service is still quite low, representing about 3.9 percent of the government expenditures. However, it has gradually risen at a rate that is faster than the rate of growth of the economy. The total debt service was only US$ 8.3 million in 2001 as compared to an amount of US$ 40.8 million in 2003 and US$ 21.9 million in 2004.

7. Allocation of Funding. The allocation of treasury-executed spending between the levels of government by function is presented in Table 2.8. For core government functions, the allocation of funds to the provincial treasuries has increased over time. In 1998, the central ministries consumed 96 percent of the funds and a mere 4 percent was allocated to the provinces. By 2002, the ratio changed to 93 and 7 percent, respectively. By 2004, the RGC was allocating 11 percent the total budget to the Provinces to cover their core administrative functions.

Table 2.8: Expenditure by Sector and Administrative Level, 1996-2005 (% of Sectoral Government Spending)

Function	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005B
Core Government										
Central	**94%**	**95%**	**96%**	**97%**	**97%**	**96%**	**93%**	**90%**	**89%**	**88%**
Provincial	**6%**	**5%**	**4%**	**3%**	**3%**	**4%**	**7%**	**10%**	**11%**	**12%**
Economic Services										
Central	**82%**	**88%**	**87%**	**88%**	**88%**	**90%**	**90%**	**88%**	**87%**	**89%**
Provincial	**18%**	**12%**	**13%**	**12%**	**12%**	**10%**	**10%**	**12%**	**13%**	**11%**
Agriculture										
Central	63%	73%	68%	60%	72%	80%	77%	79%	77%	84%
Provincial	37%	27%	32%	40%	28%	20%	23%	21%	23%	16%
Transport										
Central	80%	90%	83%	84%	93%	94%	95%	92%	93%	94%
Provincial	20%	10%	17%	16%	7%	6%	5%	8%	7%	6%
Other Economic Services										
Central	91%	94%	94%	96%	91%	93%	93%	91%	88%	90%
Provincial	9%	6%	6%	4%	9%	7%	7%	9%	12%	10%
Environmental Protection										
Central	62%	61%	65%	67%	69%	81%	79%	77%	79%	78%
Provincial	38%	39%	35%	33%	31%	19%	21%	23%	21%	22%
Rural Development										
Central	**77%**	**71%**	**81%**	**88%**	**67%**	**81%**	**88%**	**91%**	**91%**	**86%**
Provincial	**23%**	**29%**	**19%**	**12%**	**33%**	**19%**	**12%**	**9%**	**9%**	**14%**
Social Services										
Central	**26%**	**31%**	**27%**	**43%**	**37%**	**40%**	**44%**	**44%**	**45%**	**45%**
Provincial	**74%**	**69%**	**73%**	**57%**	**63%**	**60%**	**56%**	**56%**	**55%**	**55%**
Health										
Central	61%	72%	71%	84%	69%	69%	66%	65%	70%	68%
Provincial	39%	28%	29%	16%	31%	31%	34%	35%	30%	32%
Education										
Central	17%	16%	15%	23%	22%	27%	35%	35%	38%	34%
Provincial	83%	84%	85%	77%	78%	73%	65%	65%	62%	66%
Other Social Services										
Central	11%	15%	13%	15%	31%	32%	32%	36%	30%	29%
Provincial	89%	85%	87%	85%	69%	68%	68%	64%	70%	71%
Total										
Central	**78%**	**80%**	**82%**	**81%**	**80%**	**79%**	**78%**	**76%**	**74%**	**73%**
Provincial	**22%**	**20%**	**18%**	**19%**	**20%**	**21%**	**22%**	**24%**	**26%**	**27%**

Source: Based on World Bank estimates and MEF TOFE.

Table 2.8 shows that within each category of expenditure the relative size of the central government's activities, except for health, is rising relative to those of the provincial governments. In agriculture and transport, the share of the central government has been increased from 68 and 83 percent in 1998 to 77 and 93 percent in 2004. In education and other social services, the share increased from 15 and 13 percent in 1998 to 38 and 30 percent, respectively, in 2004. However, because of the substantial shift in the emphasis of government expenditures from its core administration in favor of the education budget, which is relatively heavily weighted towards the provincial level of administration, the proportion of total government expenditures carried out by the provincial governments has actually increased over time.

In 1998 the overall proportion of provincially-executed spending was 18 percent, while in 2004 the provinces had 26 percent of the total public sector budget to spend. Whether the decentralization of expenditures to the provinces was a good thing is an issue of the relative administrative capacity of the different levels of government and the nature of certain services, such as primary education that in theory could be best delivered by a lower level of government. In this situation where governance is weak in general, then putting more responsibilities on the relatively weaker provincial government is likely to lead to more economic waste. From the data it seems that Cambodia has been making this trade-off by increasing central government control of most areas of expenditure while expanding the operational activities of the provincial governments in areas were the nature of the services warrants it.

COMPOSITION OF EXPENDITURE

8. Current Expenditure on Civil Administration. Civil administration here refers to all government operations excluding defense and security. Significant changes have occurred in the way the current expenditures are allocated. The two largest items in the current expenditure of the government are the salaries/allowances and operating costs. Over the period from 1998 to 2004, the expenditures on salaries and allowances of the civil administration rose from 1.3 percent of GDP to 1.6 percent, as presented in Table 2.9. During 1998-2001 the operating costs increased significantly from 1.6 percent of GDP to 3.0 percent. Because of the government's effort to reduce the operating expenditure, the next period witnessed a reduction in the operating costs of the civil administration from 3.0 percent of GDP in 2001 to 2.1 percent in 2004. The 2005 budget indicates that the government's intentions are to further increase the salaries and allowances of the civil servants and, at the same time, to cut the operating costs of the administration to 1.8 percent of GDP.

Table 2.9: Treasury-Executed Civil Administration Expenditure by Economic Category, 1996-2005 (% of GDP)

Budget Chapter	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005B
Sub-Total Current Expenditure	**4.2**	**3.9**	**4.1**	**4.7**	**5.4**	**6.4**	**7.0**	**7.4**	**6.3**	**6.0**
10 : Salaries and Allowances	1.3	1.3	1.3	1.4	1.5	1.5	1.8	1.8	1.6	1.6
11 : Operating Costs	1.7	1.6	1.6	2.0	2.5	3.0	2.6	2.7	2.1	1.8
12 : Subsidies for provincial admin.	0.2	0.2	0.1	0.1	0.1	0.2	0.3	0.6	0.5	0.5
13 : Special programme agreements	0.0	0.0	0.2	0.0	0.1	0.5	0.8	0.8	0.7	0.7
20 : Interest on loans	0.1	0.1	0.1	0.2	0.1	0.1	0.2	0.2	0.2	0.2
30 : Economic transfer payments	0.2	0.1	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.1
31 : Social transfer payments	0.6	0.6	0.5	0.7	0.6	0.7	0.7	0.8	0.6	0.5
32 : Transfer to international org.	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
40 : Miscellaneous	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.2	0.1	0.5
41 : Contingencies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Sub-Total Capital Expenditure	**1.2**	**0.9**	**1.0**	**1.7**	**2.2**	**1.9**	**3.6**	**3.5**	**2.1**	**2.3**
50.1 : Construction & Equipment	0.6	0.7	0.7	1.4	1.6	1.2	2.8	1.9	1.0	1.4
50.2 : Counterpart funds	0.1	0.2	0.3	0.2	0.6	0.3	0.6	0.5	0.5	0.4
50.3 : Investment by foreign funds	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.5	0.4	0.2
52 : Financial Operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
53 : Debt amortization	0.5	0.1	0.0	0.1	0.1	0.1	0.1	0.6	0.2	0.4
Total	**5.3**	**4.9**	**5.1**	**6.4**	**7.7**	**8.2**	**10.6**	**10.9**	**8.3**	**8.3**

Source: MEF TOFE reports.

Given the fact that the salaries of civil servants are currently set at a very low level, it is expected that the proportion of Chapter 10 (salaries and allowances) spending should increase in relative and absolute terms in the near future. Table 2.10 presents the ratio of operating expenditures, which cover administrative costs, including office costs, vehicle costs, expenditure on meetings and training, and travel, as well as a range of program expenditures, to salaries and allowances paid out to civil servants in the respective institutions. For the general administration and the judiciary, operating costs have significantly declined in recent years. The overall operating expenditure on core government services fell from 3.0 times in 1998 to 2.3 times in 2004. The increase of funding for economic services, rural development, and social services has resulted in a general increase in the ratio of operating expenses to salaries and allowances, as is reported in Table 2.10. Thus, for economic services the combined ratio rose from 2.4 times in 1998 to a peak of 4.0 times in 2001, and then declined to a level of 2.5 times in 2005. The ratios for rural development and social services were 1.2 and 0.6 in 1998, and both gradually rose to 6.4 and 1.4, respectively, by 2005. For these sectors it is understandable that operating costs should be relatively high if the service delivery is to be effective. All require offices, travel and expenditures on goods and services for the reliable delivery of their programs.

Table 2.10: Ratio of Operating Expenditures to Salaries and Allowances by Function, 1996-2005 (times)

Function	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Core Government	**1.7**	**1.9**	**3.0**	**2.6**	**3.2**	**4.3**	**2.6**	**2.7**	**2.3**	**1.4**
General Administration	1.7	1.9	3.0	2.5	3.2	4.3	2.7	2.8	2.4	1.5
Judiciary	1.7	2.2	1.3	3.7	4.0	4.3	1.9	1.0	0.7	0.9
Economic Services	**2.8**	**2.3**	**2.4**	**3.3**	**3.0**	**4.0**	**2.6**	**3.0**	**2.3**	**2.5**
Agriculture	1.5	1.1	1.1	1.7	2.1	3.2	2.4	2.7	2.7	2.4
Transport	0.5	0.5	0.4	0.8	0.9	1.2	0.7	1.1	0.8	0.9
Public Works	0.4	0.3	0.3	0.8	1.0	1.3	0.8	0.8	0.7	0.7
Other Transport	0.9	1.1	0.8	0.8	0.8	1.1	0.7	1.9	1.0	1.6
Other Economic Services	7.1	6.5	6.7	8.6	6.7	7.2	4.6	5.1	3.2	3.9
Environmental Protection	2.9	1.7	1.5	1.8	2.4	4.6	2.3	2.4	2.0	1.7
Rural Development	**1.4**	**1.1**	**1.2**	**1.5**	**4.2**	**7.3**	**6.4**	**5.3**	**5.1**	**6.4**
Social Services	**0.8**	**0.7**	**0.6**	**0.8**	**1.0**	**1.4**	**1.4**	**1.4**	**1.4**	**1.4**
Health	3.6	3.3	3.1	5.1	6.3	8.3	6.0	6.5	6.7	6.2
Recreation, Culture & Religion	0.8	1.0	0.7	1.3	2.6	2.9	2.5	2.6	2.3	2.4
Education	0.3	0.2	0.2	0.3	0.3	0.5	0.7	0.6	0.7	0.6
Social Protection	1.4	1.3	0.8	1.5	2.4	3.6	2.7	2.9	2.4	1.7
Total	**1.3**	**1.2**	**1.4**	**1.4**	**1.7**	**2.4**	**1.9**	**1.9**	**1.8**	**1.5**

Source: Based on World Bank estimates and MEF TOFE.

Table 2.11 presents the government expenditures on civil administration over a period 1996-2005 in US$ million at constant 2005 prices. The size of government spending on total current expenditures in real terms has increased from US$ 134.4 million in 1998 to US$ 341.8 million in 2004, and was budgeted to rise to US$ 369.0 million in 2005. At the same time, the total capital expenditure was increased from US$ 34.0 million in 1998 to US$ 113.0 million in 2004, and US$ 144.3 million in 2005.

Total spending on salaries and allowances of civil servants represented 26.0 percent of the current expenditure in 2004. The civil administration operational spending, defined as Chapter 11 and 13 expenditures, accounted for another 45.8 percent of the current expenditure in the same period. The composition of capital expenditures in 2004 was such that 47.9 of the total was internally financed (Chapter 50.1). Funds paid by the government to cover the counterpart funds required by foreign and agenesis undertaking capital projects in Cambodia cover 24.7 percent of the capital budget (Chapter 50.2). External aid accounted for 19.1 percent of the budget (Chapter 50.3). Debt amortization is reported as capital expenditures in the accounts of the government and made up for the remaining 8.2 percent of the capital spending.

Table 2.11: Treasury-Executed Civil Administration Expenditure by Economic Category, 1996-2005 (US$ millions, constant 2005 prices)

Budget Chapter	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005B
Sub-Total Current Expenditure	**123.3**	**122.3**	**134.4**	**172.8**	**217.2**	**274.2**	**318.5**	**367.2**	**341.8**	**369.0**
10 : Salaries and Allowances	39.1	41.2	42.8	52.6	60.6	64.0	83.0	89.5	88.8	100.3
11 : Operating Costs	50.5	50.7	52.9	74.1	101.6	130.7	120.1	132.2	117.1	110.6
12 : Subsidies for provincial admin.	5.4	5.2	4.5	4.1	5.7	6.9	15.4	29.2	29.5	31.2
13 : Special programme agreements	0.1	0.3	8.1	1.4	3.2	20.5	37.7	38.0	39.4	43.2
20 : Interest on loans	4.1	2.9	4.1	6.2	6.0	6.0	7.5	9.3	12.6	12.2
30 : Economic transfer payments	4.8	2.0	4.0	3.3	8.9	9.7	13.7	16.4	16.5	4.5
31 : Social transfer payments	17.2	19.0	17.4	25.9	25.8	31.8	33.5	41.0	32.5	29.1
32 : Transfer to international org.	2.0	0.4	0.6	1.3	1.7	2.3	2.1	2.0	2.6	2.3
40 : Miscellaneous	0.0	0.6	0.0	3.9	3.7	2.2	5.3	9.6	2.8	30.7
41 : Contingencies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.9
Sub-Total Capital Expenditure	**34.5**	**29.3**	**34.0**	**63.8**	**89.0**	**80.1**	**164.7**	**172.1**	**113.0**	**144.3**
50.1 : Construction & Equipment	16.7	22.5	23.3	53.3	63.2	53.2	126.9	93.1	54.2	84.5
50.2 : Counterpart funds	3.1	5.0	9.2	7.5	23.0	14.8	27.9	25.0	27.9	24.4
50.3 : Investment by foreign funds	0.0	0.0	0.0	0.0	0.0	9.8	7.1	22.4	21.6	13.4
52 : Financial Operations	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0
53 : Debt amortization	14.7	1.8	1.5	2.9	2.8	2.4	2.5	31.6	9.3	22.0
Total	**157.8**	**151.6**	**168.4**	**236.6**	**306.1**	**354.3**	**483.2**	**539.3**	**454.8**	**513.3**

Source: MEF TOFE reports.

9. Capital Expenditure. As Table 2.9 indicated, there has been an increasing trend in the internally financed and executed capital expenditure (Chapter 50.1) over a period of 1998 to 2002. It increased from 1.0 percent of GDP in 1998 to a sizeable 3.6 percent in 2002. However, the share of capital expenditure undertaken by public sector then declined to 2.1 percent of GDP by 2004, and was budgeted to use 2.3 percent of GDP in 2005.

Table 2.12 presents a summary of treasury-executed capital expenditures over 2002-05 in 2005 constant prices. The amount of capital expenditure on new projects has been falling in absolute and relative terms over this period. The total spending under Chapters 50.1-50.3 reached US$ 92.9 million (2.0 percent of GDP) in 2002, while it amounted to only US$ 77.0 million (1.4 percent of GDP) in 2004. This reduction was not adequately covered by an increase in maintenance spending under Chapter 30.03, although it has been increased from US$ 4.8 million (0.1 percent of GDP) in 2002 to US$ 13.1 million (0.2 percent of GDP) in 2004. The size of maintenance expenditures remains very small and hardly covers the needs of maintaining the stock of existing capital assets. Generally, the amount of annual maintenance expenditures on infrastructure should be, at least, 5 percent of the initial investment costs of infrastructure assets.

From Table 2.12 we find that in the level of maintenance expenditure made in 2003, 2004 and 2005 would only be sufficient to cover the required maintenance on the previous three years of new capital expenditures.[12] This raises the issue of sustainability of the current capital investment program by the RGC and donors' community.

Table 2.12: Treasury-Executed Capital Expenditure by Chapter, 2002-05 (US$ millions, constant 2005 prices)

	2002	2003	2004	2005B
Ch. 50.1: Construction and equipment	63.6	54.1	37.5	36.1
Ch. 50.2: Counterpart on externally financed	18.1	19.1	22.2	20.2
Ch. 50.3: Investment by foreign funds	11.2	17.7	17.3	10.6
Sub-total:	**92.9**	**90.9**	**77.0**	**67.0**
Ch. 30.03: Maintenance budget	4.8	12.5	13.1	10.9
Total:	**97.7**	**103.4**	**90.1**	**77.9**
Ch. 50.1-50.3 as share of GDP	2.0%	1.8%	1.4%	1.1%
Ch. 30.03 as share of GDP	0.1%	0.3%	0.2%	0.2%

Source: MEF TOFE Reports and own estimates.

Table 2.13 looks at the sectoral allocation of the capital expenditures financed from the internal government resources (Chapter 50.1). The structure of spending on government's projects is somewhat erratic at the sectoral level, reflecting the impact of a few construction projects on a relatively small government project portfolio. In 2001, the capital budget was driven by public works transport projects, accounting for one third of the whole government's capital expenditure budget. Economic services, including transport, accounted for 61.1 percent of the capital projects financed by the government from internal sources, while all social services combined had only 14.5 percent of the capital budget. This is less than such projects carried over for the general administration (14.9 percent). Expenditure on rural development was only 8.6 percent of the total capital budget.

Because of the data limitations and change in the reporting standards in 2001, a comparative sectoral analysis beyond that period is not possible. Due to the small number of capital projects financed from own government resources (Chapter 50.1), the sectoral distribution is project-dependent. However, as Table 2.11 and 2.12 already indicated, the overall size of the capital budget is small.

[12] For a new paved road, the annual maintenance costs are approximately 8 percent of the initial investment costs. For a gravel road, the annual maintenance costs are approximately 40 percent of the initial investment costs. "Capital Appraisal Handbook", Prepared for: Department of Finance and Economic Development, Limpopo Provincial Government, Polokwane, South Africa. Prepared by: Cambridge Resources International, Cambridge, MA, USA (2004).

Table 2.13: Expenditure on Government Projects (Capital Expenditures) by Function, 1996-2004 (% of Total)

Function	1996	1997	1998	1999	2000	2001	2002	2003	2004
Core Government	**48.2**	**24.2**	**55.8**	**14.3**	**48.3**	**15.8**	**30.2**	**14.7**	**13.7**
General Administration	48.1	2.5	50.5	13.0	48.2	14.9	6.4	13.5	8.9
Defense	-	-	-	-	-	0.9	0.2	-	-
Security	-	21.7	4.8	1.2	-	-	-	1.2	4.8
Judiciary	0.2	-	0.4	0.1	0.0	-	23.6	-	-
Economic Services	**43.5**	**62.5**	**38.5**	**50.1**	**38.9**	**61.1**	**35.9**	**24.9**	**24.3**
Agriculture	4.5	9.3	3.4	0.3	2.3	7.0	2.5	1.4	2.4
Transport	32.8	25.7	10.9	11.1	24.4	35.9	23.6	17.2	18.1
Other Economic Services	5.9	27.4	24.2	38.6	12.2	17.9	9.5	6.4	3.2
Environmental Protection	0.3	0.1	-	0.0	-	0.3	0.2	-	0.5
Rural Development	**5.4**	**1.4**	**4.3**	**6.4**	**2.2**	**8.6**	**9.3**	**18.2**	**27.6**
Social Services	**2.9**	**11.9**	**1.4**	**29.3**	**10.7**	**14.5**	**2.0**	**3.3**	**2.5**
Health	0.7	8.4	0.5	25.6	0.2	0.2	0.3	0.6	1.3
Recreation, Culture & Religion	0.1	0.3	0.2	0.0	5.4	7.6	1.6	1.5	0.1
Education	1.9	1.2	0.4	3.0	1.8	5.5	0.1	1.2	1.1
Social Protection	0.2	2.0	0.3	0.6	3.3	1.3	-	-	-
Unallocated *	**-**	**-**	**-**	**-**	**-**	**-**	**22.6**	**38.9**	**31.9**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: MEF TOFE Reports and own estimates.
*Note: * The reporting system for capital spending was changed in 2001. The capital expenditures that were reported in the following periods but could not be traced back to the specific ministry were summarized into the "unallocated" line.*

From table 2.14 we find that government financed project spending is not evenly spread across the sectors. In 2001, the share of government project spending in the overall core government functions was only 3.5 percent of the total sector expenditures, as compared to 6.6 percent in 1998. By 2002 this share had fallen to 1.2 percent. In the economic services sector, the share of government capital spending is significantly higher, totalling 34.3 percent in 1998, but later reaching 41.2 percent in 2001 and 48.5 percent in 2002. The spending on the economic services fell to 20.4 and 25.4 percent in 2004 and 2005, respectively. In transport and public works sectors particularly, the rate of government projects is substantial, 63.5 percent of the total sector expenditures in 2001. It was budgeted at a rate of about 56 percent of the total sector expenditures in 2005. Rural development is also characterized by a high density of government capital spending, amounting to 54.5 percent of the total sector expenditures in 2001, compared to only 35.8 percent in 1997. It has remained high and was targeted at a level of 56.8 percent of the total sector expenditures in 2005. In social services, only recreation, culture and religion activities appear to have some sizable projects executed in 2000-2001. Health had substantial project spending in 1997 and 1999.

It should be noted that the "unallocated" project spending presented in Table 2.13 is not reflected in the sectoral analysis of Table 2.14. This affects the government project spending (Chapter 50.1) only in periods after 2001, but would alter the share of government participation in sectors significantly.

Table 2.14: Government Capital Projects as Share of Total Capital and Current Expenditure, 1996-2005 (%)

Function	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Core Government	**4.3**	**3.8**	**6.6**	**3.8**	**11.9**	**3.5**	**14.0**	**5.1**	**3.2**	**2.0**
General Administration	15.8	1.6	16.1	10.1	24.2	6.6	6.2	8.2	3.8	3.9
Defense	-	-	-	-	-	0.6	0.3	-	-	-
Security	-	14.8	2.9	1.8	-	-	-	2.8	6.6	0.4
Judiciary	3.2	-	17.4	3.5	1.2	-	93.9	-	-	-
Economic Services	**22.4**	**44.2**	**34.3**	**52.1**	**45.1**	**41.2**	**48.5**	**28.7**	**20.4**	**25.4**
Agriculture	12.3	35.9	16.4	2.2	14.2	20.3	16.5	6.1	7.9	13.3
Transport	59.5	62.8	51.4	63.3	69.2	63.5	71.0	51.6	34.6	54.6
Public Works	62.6	52.7	51.2	68.1	72.0	63.3	73.4	55.0	36.6	57.9
Other Transport	42.7	80.1	51.8	36.0	35.2	64.3	-	-	-	22.6
Other Economic Services	6.0	37.7	35.3	59.7	36.6	33.6	40.3	22.5	10.1	3.1
Environmental Protection	6.4	4.0	-	2.7	-	7.4	13.1	-	12.9	9.4
Rural Development	**54.5**	**35.8**	**63.1**	**79.3**	**38.9**	**54.5**	**67.1**	**75.6**	**74.8**	**56.8**
Social Services	**0.8**	**5.6**	**0.6**	**16.4**	**6.3**	**5.9**	**1.6**	**1.8**	**0.8**	**0.9**
Health	0.8	14.2	1.0	40.0	0.4	0.2	0.9	1.1	1.4	1.8
Recreation, Culture & Religion	0.5	4.2	3.0	0.2	43.4	44.8	24.1	16.0	0.7	1.1
Education	1.2	1.3	0.3	3.9	2.5	4.8	0.1	1.4	0.8	0.5
Social Protection	0.2	3.6	0.5	2.0	8.4	2.8	-	-	-	-
Share of Total Capital and Current Expenditures	**6.0**	**10.1**	**8.4**	**15.3**	**15.0**	**11.6**	**23.4**	**17.3**	**11.1**	**16.7**

Source: MEF TOFE Reports and own estimates.
Note: Chapter 50.1 to current Government expenditures plus Chapter 50.1

EXTERNALLY-FINANCED EXPENDITURE

10. Significance of External Flows. External financing remains critical for investment in infrastructure and capacity building. As shown earlier in Table 2.1, the share of external financing has gradually declined from 60.7 percent of the total spending in 1998 to 48.3 percent in 2003. While this trend is expected to continue, it is unlikely that the share of domestic financing will rapidly increase in the medium term. Over the period of 1996-2003, Cambodia received US$ 3,754 million of external assistance, which compares to US$ 3,143 million treasury-executed expenditures over the same time. The clear picture of donor dependency is illustrated at the sector level in Table 2.15.

Funding for the core government function includes all the items listed in Annex C under the broad categories of: "Development Administration" and "Disaster Preparedness". Over the period from 1998-2000 the flow of international aid has been declining from 32.9 percent of the total spending to 23.7 percent due to a reduction in the development management funding. External financing of the core government functions fell to a level of 23.7 percent of the total external spending by 2000, but following the flood in 2000, there was a sharp increase in the amount of the disaster preparedness funds. As a result, despite the continuing downward trend of development management funding, the size of external financing of core government increased by 2003.

Table 2.15: Functional Structure of External Assistance, 1996 to 2003 (% of Total Spending) [13]

Summary Function	1996	1997	1998	1999	2000	2001	2002	2003
Core Government	**43.1**	**33.1**	**32.9**	**24.1**	**23.7**	**27.6**	**31.6**	**26.6**
Economic Development	**81.9**	**70.0**	**80.9**	**66.4**	**69.9**	**58.8**	**61.8**	**67.1**
Agriculture	90.2	69.1	71.8	79.7	82.7	67.4	67.4	66.7
Transport	85.2	74.5	90.5	79.0	69.9	68.1	66.8	71.4
Other Economic Services	67.7	64.8	74.8	51.5	53.6	24.4	25.3	46.5
Environmental Protection	80.6	91.8	90.1	82.8	68.1	33.4	88.2	90.5
Rural Development	**97.7**	**98.2**	**97.5**	**93.4**	**95.5**	**88.8**	**75.7**	**70.2**
Social Development	**60.0**	**60.0**	**74.5**	**59.6**	**59.5**	**59.6**	**58.0**	**59.7**
Health	72.8	63.7	84.3	68.3	71.9	65.9	61.4	67.7
Education	53.0	63.1	68.7	50.3	48.9	44.4	49.5	50.7
Community & Social Services	52.3	49.0	69.3	56.3	55.1	68.6	66.5	62.1
Humanitarian Aid & Relief	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Total	**60.4**	**55.2**	**60.7**	**53.4**	**54.1**	**52.0**	**49.1**	**48.3**

Source: Based on World Bank estimates, CDC database and MEF TOEF reports.

The share of external assistance to agriculture (agriculture, forestry and fisheries) rose from 71.8 percent in 1998 to 82.7 percent of total spending by 2000, but then again declined to 66.7 percent by 2003. The foreign support to transport was recorded as 90.5 percent of the total sector spending in 1998, gradually decreasing to 66.8 percent by 2002. In 2003, however, it was raised to a level of 71.4 percent. The other economic services include the following sectors: industry, energy, international trade, domestic trade, and communications. There is a visible trend of reducing the volume of external assistance to these sectors, which reduced from a peak of 74.8 percent of sector spending in 1998 to 25.3 percent in 2002. In 2003 additional funds were forwarded towards industry and energy sectors, pushing the combined share of foreign assistance to 46.5 percent, as Table 2.15 illustrates. The environmental protection sector in Table 2.15 corresponds to "natural resources" spending according to the Development Cooperation Report. Since 1998, the share of external funding first declined from 90.1 percent in 1998 to a low of 33.4 percent in 2001, but then was restored to the initial level by 2003. The overall dependence of the economic sectors on external assistance has remained high. Some reduction of this dependence has taken place, as the share of external funding was 80.9 percent of the total sector spending in 1998 and it declined to 67.1 percent by 2003. But the relative figure tells us that two thirds of funding for the economically productive sectors still comes from abroad.

The external assistance to the rural development has declined over time due to increased government participation in the sector. In 1998 this sector almost entirely depended on the

[13] The Development Cooperation Report prepared by the Council of Development of Cambodia that gathers comprehensive information on external assistance flows from all donors has not been released for 2004 and 2005.

foreign aid (97.5 percent), while by 2003, the government contributed 29.8 percent of the total spending. The same trend is apparent in both education and health sectors which have been marked as priority sectors and received an additional allocation of funds from the government, thus reducing the share of external assistance. The community & social services reported in Table 2.15 correspond to the funds towards "social development" according to the Development Cooperation Report, and described in Annex C.

The only sector where external assistance is relatively low is the core government functions, with 26.6 percent of the total spending being financed through aid in 2003. In environmental protection, health and humanitarian aid and relief, the external assistance constitutes nearly 100 percent of the total sector expenditure. In agriculture and education sectors, the external financing in 2003 was recorded at 66.7 and 50.7 percent of the total sector spending, respectively. From Table 2.15 we see that the share of external financing has been gradually reduced from 60.7 percent of the total expenditures in 1998 to 48.3 percent in 2003. However, most of sectors are heavily dependent on external assistance.

There has been a gradual shift in the functional composition of external assistance, though there is no marked trend toward the priority sectors. Table 2.16 presents the allocation of external assistance across the sectors. The share of foreign assistance towards the core government activities decreased from 22.1 percent of the total external flow in 1998 to 16.7 percent in 2003. Likewise, the external financing of rural development declined from 14.6 percent in 1998 to only 9.0 percent in 2003, which is explained by increased government participation in rural development activities.

Table 2.16: Functional Composition of External Financing, 1996-2003 (% of Total External Financing)

Summary Function	1996	1997	1998	1999	2000	2001	2002	2003
Core Government	**31.1**	**25.5**	**22.1**	**15.2**	**15.5**	**17.9**	**22.3**	**16.7**
Economic Services	**37.5**	**26.8**	**25.5**	**24.4**	**24.8**	**22.2**	**26.8**	**28.3**
Agriculture	14.5	4.7	2.9	6.4	9.5	7.5	7.1	7.3
Transport	13.5	9.7	10.9	8.5	10.1	12.7	15.0	13.2
Other Economic Services	8.7	10.9	10.9	8.8	4.7	1.8	1.8	3.9
Environmental Protection	0.8	1.5	0.8	0.7	0.5	0.2	2.9	3.8
Rural Development	**17.6**	**17.7**	**14.6**	**14.5**	**14.4**	**13.1**	**9.6**	**9.0**
Social Services	**22.3**	**25.9**	**35.6**	**34.0**	**31.0**	**38.3**	**38.5**	**42.4**
Health	9.8	8.4	14.5	17.7	14.5	14.0	13.0	17.1
Education	7.8	12.6	13.4	10.1	8.7	9.5	13.2	14.0
Community & Social Services	4.7	4.9	7.6	6.2	7.8	14.8	12.3	11.3
Humanitarian Aid & Relief	**2.8**	**4.1**	**2.3**	**11.8**	**14.3**	**8.5**	**2.7**	**3.7**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Based on World Bank estimates, CDC database and MEF TOEF reports.

The inflow to economic and social services substantially increased over the same period. The size of assistance allocated to agriculture increased from 2.9 percent in 1998 to 7.3 percent in

2003. In health and education, the assistance inflow was 14.5 and 13.4 percent in 1998, and both rose to a level of 17.1 and 14.0 percent in 2003, respectively. The observable trend that took place over the period from 1998 to 2003 was a shift of external assistance from core government and disaster management funding to economic and social services. As Table 2.16 suggests, the main beneficiaries are the transport, health, education, community and social services, and environmental protection.

The total flow of external assistance in absolute figures is presented in Table 2.17 in constant 2005 prices. The total size of external assistance was US$ 650.8 million in 1996 and was US$ 584.7 million in 2003. However, during this period it first fell in real terms by approximately US$ 180 million to US$ 470.4 million in 1997, and then gradually increased. The size of government budget, as shown in Annex B, rose from US$ 296.4 million in 1998 to US$ 632.2 million in 2003, or a 113.9 percent rise in real terms. In other words, while the flow of foreign assistance has not significantly increased over the period from 1998-2003, the government's ability to raise revenue and to increase spending have both improved considerably.

Table 2.17: Total External Assistance by Summary Function, 1996-2003 (US$ millions, constant 2005 prices)

External Assistance by Summary Function	1996	1997	1998	1999	2000	2001	2002	2003
Core Government	**202.7**	**119.8**	**115.5**	**71.7**	**82.8**	**94.2**	**129.4**	**97.4**
Economic Development	**209.9**	**126.1**	**133.2**	**115.5**	**132.2**	**116.3**	**156.0**	**165.2**
Agriculture	81.1	22.1	15.0	30.2	50.5	39.4	41.3	42.6
Transport	75.7	45.7	56.9	40.1	53.9	66.4	87.2	77.2
Other Economic Services	48.9	51.1	57.1	41.8	25.3	9.4	10.4	22.9
Environmental Protection	4.2	7.2	4.2	3.4	2.4	1.1	17.1	22.5
Area Development	**98.1**	**83.4**	**76.4**	**68.7**	**77.0**	**68.8**	**55.8**	**52.7**
Social Development	**124.7**	**121.7**	**186.4**	**160.9**	**165.4**	**201.0**	**224.0**	**247.7**
Health	54.9	39.3	76.1	83.8	77.5	73.5	75.5	99.8
Education	43.6	59.3	70.4	47.8	46.3	50.0	76.9	81.6
Community & Social Services	26.2	23.1	40.0	29.3	41.7	77.5	71.6	66.3
Humanitarian Aid & Relief	**15.4**	**19.4**	**11.8**	**55.9**	**76.5**	**44.6**	**15.9**	**21.5**
Total	**650.8**	**470.4**	**523.4**	**472.7**	**534.0**	**525.0**	**581.2**	**584.7**

Source: Based on World Bank estimates, CDC database and MEF TOEF reports.

According to Table 2.18, the geographical allocation of external funding is such that nation-wide programs are reported to occupy roughly a third of the donors' portfolio, specific projects in provinces also consume another third of the total disbursements. Projects located in one of the provinces are reported as in "provinces", as opposite to projects that involve more than one province and consequently reported as "nation-wide". The spending in and around the capital, and "not reported" assistance account for the reminder of the total contribution by donors.

Table 2.18: Geographical Allocation of External Assistance (% of Funds Disbursed)

	2002	2003
Nation-wide	33.9%	32.7%
Phnom Penh	19.6%	16.0%
Provinces	34.6%	30.8%
Not reported	11.9%	20.5%
Total	**100%**	**100%**

Source: CDC database, 2003.

10. Technical Assistance. It has been previously reported that external assistance provided to Cambodia is heavily skewed towards technical assistance. As Table 2.19 confirms, this assertion is true because since 1998, the combined share of technical assistance has been more than 50 percent of the total flow. Project assistance has slightly increased over time, from a level of 31 percent in 1996 to 37 percent in 2003.

Table 2.19: Composition of External Assistance by Type, 1992-2003 (% of Total Inflow)

Assistance Type	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Free-Standing Technical Cooperation (FTC)	16%	24%	30%	34%	36%	48%	55%	50%	45%	37%	43%	46%
Investment-Related Technical Cooperation (ITC)	4%	2%	5%	7%	10%	7%	5%	5%	5%	6%	9%	6%
Investment Project Assistance (IPA)	13%	21%	34%	34%	31%	34%	39%	29%	31%	40%	36%	37%
Budgetary Aid/ Balance of Payments Support (PBB)	1%	23%	19%	15%	13%	1%	0%	9%	8%	10%	7%	6%
Food Aid (FOA), Emergency Relief Assistance (ERA)	67%	30%	12%	11%	11%	11%	1%	8%	12%	7%	5%	5%
Not Reported	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0.2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: CDC database, 2003.

Table 2.19 shows various components of external assistance inflows reported for the period from 1992 to 2003. Free-standing technical co-operation (FTC) is defined as the provision of resources aimed at the transfer of technical and managerial skills and know-how or of technology for the purpose of building up national capacity to undertake development activities, without reference to the implementation of any specific investment project(s). FTC includes pre-investment activities, such as feasibility studies, when the investment itself has not yet been approved or funding not yet secured. This category of assistance experienced a drop over a period 1998-2001 from a high of 55 percent to a low of 37 percent, but by 2003 it re-bounced to a level of 46 percent of the total external inflow into Cambodia.

Investment-related technical co-operation (ITC) covers the provision of resources, as a separately identifiable activity, directly aimed at strengthening the capacity to execute specific investment projects. Included under ITC would be pre-investment-type activities directly related to the implementation of an approved investment project. ITC has remained more or less stable within a range of 5-7 percent of the total external assistance. over the period 1998-2003, with the exception of year 2002 when additional funding went to project-related activities.

Investment Project Assistance (IPA) is defined as the provision of financing, in cash or in kind, for specific capital investment projects, i.e., projects that create productive capital, also known as capital assistance. Investment project assistance may have a technical co-operation component. IPA has fluctuated over the period from 1998 to 2003 from a level of 39 percent in 1998 to a low point of 29 percent in 1999 and then restoring back to a level of 35-40 percent by 2001-03.

Programme/budgetary aid or balance-of-payments support (PBB) includes the provision of assistance which is not cast in terms of specific investment or technical co-operation projects but which is instead provided in the context of broader development programme and macro-economic objectives and/or which is provided for the specific purpose of supporting the recipient's balance-of-payments position and making available foreign exchange. This category includes non-food commodity input assistance in kind and financial grants and loans to pay for commodity inputs. It also includes resources ascribed to public debt forgiveness. The amount of budgetary support was relatively high over the period 1999-2001, and then slightly lowered in the following two periods to a level of 6-7 percent of the total foreign inflows.

Food aid (FOA) covers the provision of food for human consumption for developmental purposes, including grants and loans for the purchase of food. Associated costs such as transport, storage, distribution, etc., are also included in this category, as well as donor-supplied, food-related items such as animal food and agricultural inputs related to food production, when these are part of a food aid programme. The level of food aid has not been stable. Since 1998 it increased from 1 percent to 12 percent by 2000, but then again declined to a level of 5 percent in 2003.

Emergency and relief (humanitarian) assistance (ERA) includes the provision of resources aimed at immediately relieving distress and improving the well-being of populations affected by natural or man-made disasters. Food aid for humanitarian and emergency purposes is included in this category. Emergency and relief assistance is usually not related to national development efforts nor to enhancing national capacity. Although it is recorded as official development assistance (ODA), its focus is on humanitarian assistance and not on development co-operation as such. Following the flood emergency activities in 2000, the level of this assistance was recorded at 12 percent of the total external flows in 2000 and 7 percent in 2001. During the following two periods, emergency assistance stabilized at 5 percent of the total external inflows.

11. Conclusions. From this statistical review of the size, composition and financing of the public sector in Cambodia a number of observations can be drawn. First, the peace dividend was real and the government has made the adjustment of reducing the expenditures on the military, security and also on the core administration, and has managed to reallocate these funds to the social sectors.

Second, given Cambodia's history of conflict and massive destruction of human capital, it was correct to emphasize first on education and health, because the public sector need is needed to take the lead in these areas. A question is to whether it is time now to reallocate spending to economic active sectors, directly related to employment creation.

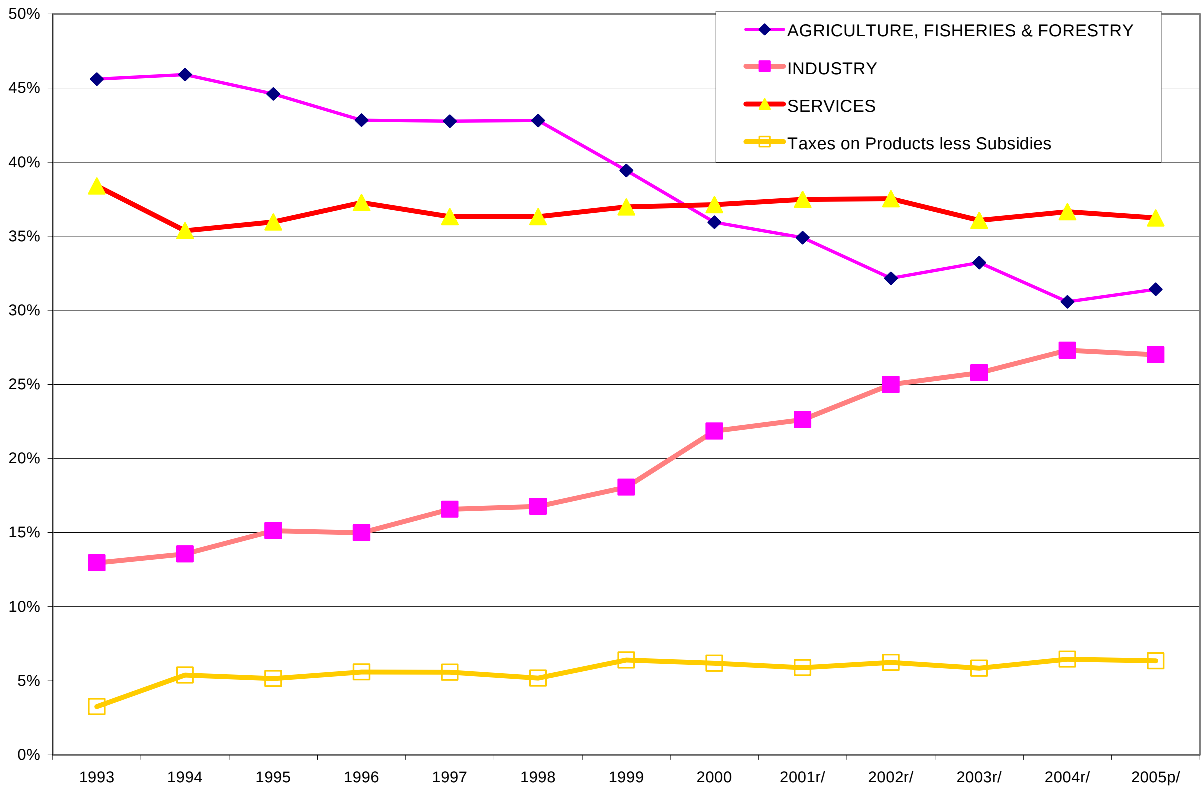
Third, Cambodia has benefited greatly from international assistance on a continuous basis for over a decade. Much of this aid has been technical assistance because of the limited skills existing in the public administration after thirty years of conflict. The question the donors now need to face is whether they should place more emphasis on capital investment or spending relatively less on human capital formation and capacity building. These issues will be addressed again in the analysis carried out below for the key sectors.

3. SPENDING AND RETURNS IN KEY SECTORS

AGRICULTURE, FORESTRY AND FISHERIES

1. **Importance of Agricultural Sector.** The agricultural sector is central to the provision of income generating activities, the reduction of poverty, and to increased food security for the majority of the population of Cambodia. At the moment, about 70 percent of the population engages in agriculture activities with the women making up the majority of farmers. Agriculture, forestry and fishing was the second largest sector in the economy in 2004, that accounted for 33.6% of GDP, also shown in Annex D. Figure 3.1 presents the sectoral contribution to GDP over a period 1993-2004. The importance of agriculture, forestry and fishing has been steadily declining in favor of industry. Agriculture still remains a very importance sector of the economy in terms of absolute and relative numbers.

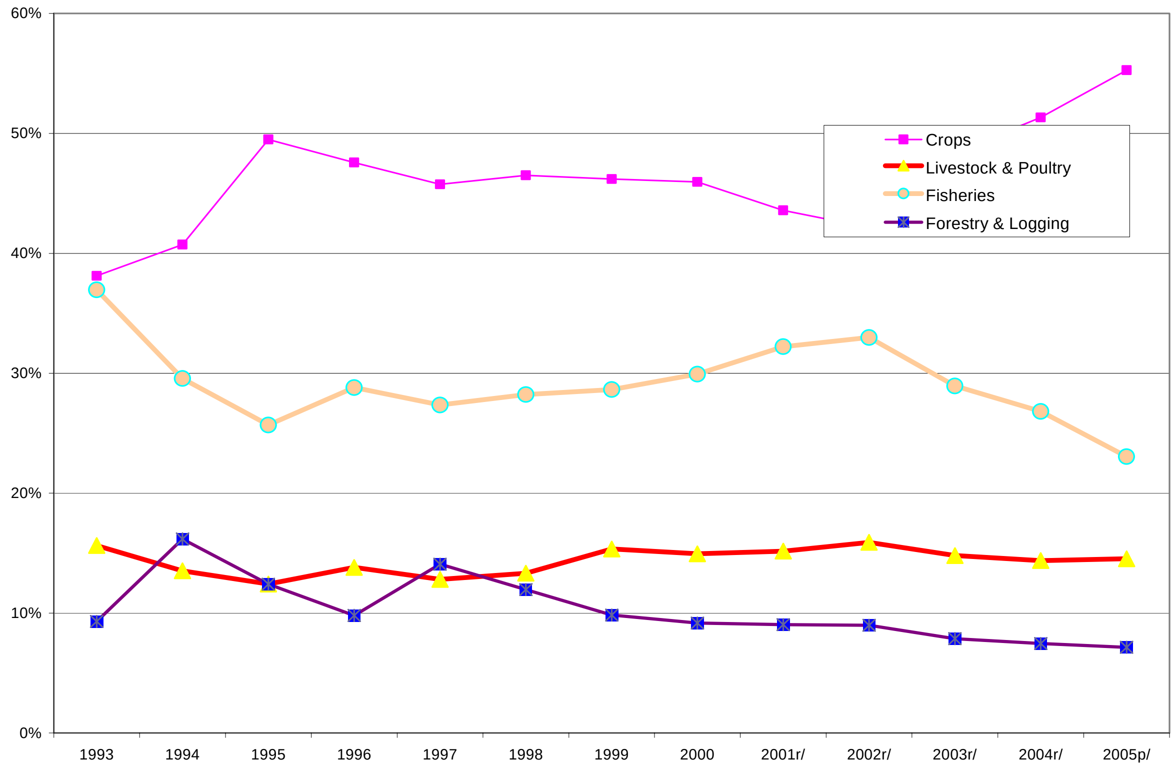
Figure 3.1: Sectoral Contribution to GDP, 1993-2004 (Share of GDP)



Source: National Accounts of Cambodia, National Institute of Statistics (NIS); and IMF Country Report: Cambodia (2005).

Figure 3.2 presents a detailed break down of sectoral activities over 1993-2004. The share of crops, mainly paddy farming, has been gradually increasing since 1998 at expense of forestry and logging. The relative share of fisheries has fluctuated around 30 percent of the sectoral value added. Livestock and poultry have experienced a decline from 19.6 percent of the sectoral value in 1993 to 16.4 percent in 2004.

Figure 3.2: Contribution to Sector Value Added by Activity, 1993-2004 (Share of Sector Value Added)



Source: National Accounts of Cambodia, National Institute of Statistics (NIS); and IMF Country Report: Cambodia (2005).

2. Sources of Funds. The governance of the agriculture, fisheries and forest resources is shared among several government agencies, mainly between the Ministry of Agriculture, Forestry and Fisheries (MAFF) and Ministry of Water Resources and Meteorology (MWRM). In addition, the Ministry of Rural Development (MRD) also plays an important role in agricultural development since it looks after essential support infrastructure and tertiary roads. The institutional framework supporting the agricultural sector also includes the Ministry of Economy and Finance (MEF) and coordination agencies (CARDI, CDC).

It appears that a number of functions executed by the different ministries and agencies overlap, and this coordination is difficult to orchestrate. Each agency appears to have its own set of dev programs, not necessarily harmonized with the other bodies and, as a result, the overall execution suffers. There is a common sense among the institutions that there is a need for a single combined development plan in regard to agriculture, fisheries and forest resources in the country, which would clearly define the domain of each ministry and set out long-term goals that have to be achieved.

There are two sources of public funds available to the sector: i) government budgets for MAFF and MWRM; and ii) external assistance.[14] As Table 2.2 suggests, government spending on agriculture by the two main ministries was relatively small until year 2001 when agriculture spending reached 0.4 percent of the GDP, and remained at a level of 0.3-0.4 percent of GDP thereafter. External assistance has provided most of the funding to the sector. As Table 2.1 suggests, the combined government and external funding has increased from 0.6 percent of GDP in 1998 to 1.3 percent in 2003. The amount of external funding has been 2-4 times the amount spent out by the government budget on agriculture over the 1998-2003 period. Table 2.8 indicated that the administrative allocation of budget between the two ministries and their provincial agencies has been such that the main ministries retain about 60-84 percent of the total budget and provinces access the remaining 16-40 percent share. Table 3.1 presents the combined MAFF and MWRM budget from 1996 to 2005 in constant 2005 prices.

Table 3.1: MAFF and MWRM Budget, 1996-2005 (% of Treasury Executed Sector Spending)

MAFF and MWRM	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
MAFF, US$ millions, constant 2005 prices	**6.0**	**7.4**	**5.1**	**5.9**	**6.7**	**9.7**	**13.0**	**12.2**	**10.7**	**12.3**
MWRM, US$ millions, constant 2005 prices	**0.0**	**0.0**	**0.0**	**0.9**	**3.4**	**8.9**	**6.6**	**9.2**	**6.9**	**13.5**
MAFF and MWRM, Total	**6.0**	**7.4**	**5.1**	**6.9**	**10.1**	**18.6**	**19.5**	**21.5**	**17.6**	**25.7**
MAFF and MWRM, Share of Sector Spending	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
1-Ministry	**63%**	**73%**	**68%**	**60%**	**69%**	**77%**	**74%**	**75%**	**72%**	**81%**
Sub-Total Current Expenditure	**50%**	**34%**	**52%**	**58%**	**52%**	**36%**	**46%**	**42%**	**50%**	**43%**
Ch. 10 : Salaries and Allowances	14%	13%	18%	16%	12%	5%	9%	7%	9%	9%
Ch. 11 : Operating Costs	36%	20%	34%	37%	37%	20%	21%	19%	24%	18%
Ch. 12 : Subsidies for provincial administration units	0%	0%	0%	0%	0%	0%	0%	6%	7%	8%
Ch. 13 : Special programme agreements	0%	0%	0%	0%	0%	3%	8%	8%	9%	7%
Ch. 30 : Economic transfer payments	0%	0%	0%	4%	1%	7%	6%	1%	0%	1%
Ch. 31 : Social transfer payments	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Ch. 32 : Transfer to international organizations	0%	0%	0%	0%	1%	2%	1%	1%	1%	0%
Sub-Total Capital Expenditure	**12%**	**39%**	**16%**	**2%**	**17%**	**40%**	**28%**	**33%**	**22%**	**38%**
Ch. 50.1 : Constructions and Equipment	12%	36%	16%	2%	14%	20%	16%	6%	8%	13%
Ch. 50.2 : Counterpart on externally financed	0%	3%	0%	0%	3%	19%	12%	8%	6%	10%
Ch. 50.3 : Investment by foreign funds	0%	0%	0%	0%	0%	1%	0%	18%	9%	14%
9-Provinces	**37%**	**27%**	**32%**	**40%**	**31%**	**23%**	**26%**	**25%**	**28%**	**19%**
Sub-Total Current Expenditure	**36%**	**27%**	**32%**	**40%**	**31%**	**23%**	**26%**	**25%**	**28%**	**19%**
Ch. 10 : Salaries and Allowances	18%	14%	18%	16%	11%	6%	8%	7%	8%	6%
Ch. 11 : Operating Costs	13%	9%	7%	16%	13%	12%	12%	13%	14%	9%
Ch. 30 : Economic transfer payments	5%	4%	6%	8%	7%	5%	6%	5%	5%	4%
Ch. 31 : Social transfer payments	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Sub-Total Capital Expenditure	**1%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**
Ch. 50.1 : Constructions and Equipment	1%	0%	0%	0%	0%	0%	0%	0%	0%	0%

Source: Estimates based on MEF TOFE.

[14] Enhancing Service Delivery through Improved resource Allocation and Institutional Reform: Integrated Fiduciary Assessment and Public Expenditure Review (IFAPER), The World Bank, 2003.

The first panel shows the total expenditures for each ministry in US$ millions at constant 2005 prices over the period 1996-2005. Because the MWRM was inaugurated in 2000, it has been increasing its share of budget relative to the MAFF, mainly due to additional funds channeled to the sector through the MWRM. Year 2005 will be the first time when the MWRM budget exceeds spending by the MAFF.

The second panel shows the allocation of the combined budget across the different categories of expenditures at the ministerial and provincial levels. Salaries at both the ministry and provincial level have been declining as a share of the budget. In regard to ministry salaries, these accounted for 18 percent of the ministry budget in 1998 while the budget for 2005 has a provision for only 9 percent. In provinces, the corresponding figure was 18 percent in 1998 and 6 percent in 2005. The level of operating costs at the ministries accounted for 34 percent of the budget in 1998, but has been gradually declining to 18 percent in 2005. A similar trend is visible in the provinces, where the level of operating costs has been decreasing from a peak of 16 percent of the total budget in 1999 to 9 percent by 2005.

In terms of the execution of expenditures, it is clear that the central ministries have taken the responsibility for the additional capital investments in sector. Table 3.1 shows that the share of central ministries was 68 percent of the total budget in 1998 and then it was gradually raised to 81 percent by 2005, which is explained by the additional capital expenditures handled at the ministerial level.

Table 3.2 presents the capital budget for MAFF and MWRM over 1999-2005. The capital spending by both institutions is driven by projects being executed through the ministry. There is no clear defined allocation level that would be maintained over years. The allocation of maintenance funds under Chapter 30.03 of the budget is clearly inadequate to maintain the existing stock of capital assets.

Table 3.2: MAFF and MWRM Capital Budget, 1999-2005 (US$ millions, constant 2005 prices)

MAFF	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
No. of Projects	n/a	n/a	n/a	1	4	1	n/a
Ch. 50.1: Construction and equipment	0.1	0.0	0.0	2.0	0.3	0.1	n/a
Ch. 50.2: Counterpart on externally financed	0.0	0.0	0.9	2.0	0.6	0.6	1.2
Ch. 50.3: Investment by foreign funds	0.0	0.0	0.1	0.0	0.6	0.0	0.0
Ch. 30.03: Maintenance budget	n/a	n/a	n/a	0	0	0	n/a
Total	**0.1**	**0.0**	**1.0**	**2.0**	**1.5**	**0.7**	**1.2**
MWRM							
No. of Projects	n/a	n/a	n/a	2	3	4	n/a
Ch. 50.1: Constructions and Equipment	0.1	1.3	3.5	1.0	0.9	1.2	3.4
Ch. 50.2: Counterpart on externally financed	0.0	0.2	2.4	2.1	1.0	0.4	2.6
Ch. 50.3: Investment by foreign funds	0.0	0.0	0.0	0.0	3.1	1.5	3.7
Ch. 30.03: Maintenance budget	n/a	n/a	n/a	0.5	0.1	0.0	0.4
Total	**0.1**	**1.5**	**5.9**	**3.6**	**5.1**	**3.1**	**10.1**

Source: Estimates based on MEF TOFE.

From the data reported by the MEF, it appears that during the period 2002-04 MAFF has not been allocated any funds from Chapter 30.03 (maintenance) at all. MWRM has been receiving a very limited amount of the maintenance funds, which is, obviously, a tiny portion of what is really needed. As a matter of illustration, in the Philippines the rehabilitation of one irrigation scheme that affected 11,500 farmer families and had a total cost of US$ 20 million and involved US$ 300,000 of maintenance expenditures a year should be borne by the farmers.[15] Public support for maintaining the major canals to the schemes will likely rely on public sector participation. These levels of investment in agriculture that are needed in order to impact on farmers live hood are in a different order of magnitude than Cambodia has been spending on maintenance in the recent years.

A major function of MAFF/MWRM should be to manage the explanation of the irrigation systems and develop the local institutions for their operation and maintenance. At the present time, however, the government is just now in the process of building a baseline inventory of the existing irrigation systems and making an assessment of their condition. Such as assessment needs to be done to prioritize where future investments in the sector should be made.

As agriculture is the primary source of livelihood for a majority of the population in Cambodia, it will be necessary for the public sector to bring the necessary infrastructure in terms if irrigation and rural roads to the countryside. There is further constraint in that many farmers do not have clear title to the land they are farming, hence, reducing their willingness to make investments in the land they cultivate. This is not a problem that is unique to Cambodia amongst the countries in the region, not is it a problem that can be quickly solved in a comprehensive manner. This problem of land little, however, needs to be solved as one of the project components of any new or improved irrigation systems. If land titles are not given as part of any new or improved irrigation schemes, then uncertainty over ownership will likely reduce the efficiency of the schemes operation.

For the rest of the country, low cost solutions to the deficiency of land titles needs to be sought. Ultimately an official accurate land register needs to be built. However, international experience in the region suggests that such a process is expensive and takes decades to solve, even with the latest satellite geographical information systems.

An option that needs to be considered is to carry out a rapid mapping and recording of the properties for the purposes of administrating a land tax. In Indonesia this was done for 60 million properties over a period of three years. The receipt for payment of the property tax became an important price of proof of the ownership of the land and has been actively used at the local level to resolve disputes over land ownership.

[15] M. Batbaatan, “Visayas Communal Irrigation Project Appraisal in Philippines”, MA Thesis in Banking and Finance, Eastern Mediterranean University, North Cyprus.

3. Project Returns. The underdeveloped nature of the agricultural sector and the abundance of labor hint that the returns on capital invested in the sector should be relatively high. While the information availability does not permit to have a fair and representative coverage of the sector activities, Table 3.3 and 3.4 present a summary of ex-ante and ex-post project returns of a sample of projects financed by the World Bank and Asian Development Bank, as reported in the project appraisal and post-evaluation documents, over the period from 1992 to 2005. As one could see, the reported project returns vary greatly from activity-to-activity and project-to-project. The lowest economic rate of return observed is 9 percent, being associated with the integrated pest management component of the Agriculture Productivity Improvement Project, World Bank, 1997. The highest economic rate of return was reported as 62 percent for the silk weaving component of the Rural Credit and Savings Project, Asian Development Bank, 2000.

The figures reported in the table should be taken with a caution as these expected returns are for projects carried out solely or mainly within the public sector, and do not represent the complete range of typical activities undertaken by Cambodian smallholder farmers. Given the great success of ACLEDA Bank, which charges lending rates in excess of 20 percent real per annum to its customers, it must be that the actual rates of return by people who are borrowing to make investment in the sector are even higher.

Table 3.4 looks at the project returns reported in water sector, which also displays a range of project returns in this sub-sector. The lowest EIRR has been estimated at 1.5 percent for the Provincial and Peri-Urban Water and Sanitation Project, World Bank, 2003, but a note attached indicates that this figure does not actually include a number of important benefits that typical make up the largest part of benefits from the rural water supply and sanitation projects.[16] At the highest end of the range, the activities of the Tonle Sap Rural Water Supply and Sanitation Sector Project, AsDB, 2005, reach an EIRR of 26.2 percent.

With the water resources, soils and rural population of Cambodia, agriculture should be a much more dynamic sector than it is presently. To bring this about the government along with the donors will need to develop a plan to begin to upgrading of the infrastructure used by the sector. Priority should be given to investments that show promise after being evaluated through the cost-benefit analysis.

[16] From research done on such schemes for Senegal the value of the time saved plus the willingness to pay for clean water plus the health and education benefits caused these projects to yield very high rate of return. *Rural Water and Sanitation Program (Phase I) in Senegal: Project Feasibility Study*, Prepared for African Development Bank, John Deutsch International Executive Programs, Department of Economics, Queen's University, Kingston, Ontario, Canada, 2005.

Table 3.3: Project Returns in Agriculture, Fishing, and Forestry

Donor / Project	Sector(s)	Approval Date	Amount (US$ million)	Executing Agency	Status	FIRR (%)	FNPV (US$ million)	EIRR (%)	ENPV (US$ million)
[AsDB] Agriculture Sector Development Program	Agriculture	Oct 2003	25.0	MAFF and MEF	Active	n/a	n/a	39%	10.3 @ 12%
[WB] Agriculture Productivity Improvement Project • Improved seed production • Integrated pest management • Livestock	Central government administration / Agriculture, fishing, and forestry	Feb 1997	27.0	MAFF	Active	n/a	n/a	• 38% • 9% • 36%	n/a
[AsDB] Rural Infrastructure Improvement Project • At appraisal (1995) • At audit (2003)	Rural Development / Agriculture, fishing, and forestry	Jul 2005	25.1	MRD	Closed	n/a	n/a	• 16.3% • 19.7%	n/a
[AsDB] Stung Chinit Irrigation and Rural Infrastructure Project • Irrigated agriculture development • Rural infrastructure	Agriculture, irrigation and drainage	Aug 2000	16.0	Ministry of Water Resources and Meteorology	Active	n/a	n/a	• 19.1% • 15.0% • 32.4%	n/a
[AsDB] Rural Credit and Savings Project • Small-scale irrigation • Pig raising • Palm sugar production • Small-scale rice milling • Silk weaving • Brick making	Finance / Rural development / Agriculture	Mar 2000	20.0	Rural Development Bank (RDB) and National Bank of Cambodia (NBC)	Active	• 29% • 54% • 60% • 23% • 91% • 30%	n/a	• 46% • 12% • 34% • 29% • 62% • 34%	n/a

Sources: Project reports of the World Bank and Asian Development Bank.

Table 3.4: Project Returns in Water Supply

Donor / Project	Sector(s)	Approval Date	Amount (US$ million)	Executing Agency	Status	FIRR (%)	FNPV (US$ million)	EIRR (%)	ENPV (US$ million)
[WB] Provincial and Peri-Urban Water and Sanitation Project	Water supply / Law and justice and public administration	Apr 2003	19.9	MIME & Phnom Penh Water Supply	Active	n/a	n/a	1.5% *****	-2.8 @ 4%
[WB] Urban Water Supply Project	Water supply / Law and justice and public administration	Feb 1998	30.96	MIME	Closed				
At appraisal									
• Phnom Penh Water Supply Authority						• 13.6%	• n/a	• 18.8%	• 24.05 @ 10%
• Sihanoukville Water Supply Authority						• 11.2%	• n/a	• 10.1%	• 0.3 @ 10%
At completion (2004)									
• Phnom Penh Water Supply Authority						• 10%	• n/a	• 12%	• n/a
• Sihanoukville Water Supply Authority						• n/a	• n/a	• 11%	• n/a
[AsDB] Phnom Penh Water Supply and Drainage Project	Urban Water and Sanitation	May 2005	16.9	Phnom Penh Water Supply Authority / Municipality of Phnom Penh	Closed				
At appraisal (1996)						6.5%	n/a	n/a	n/a
• Water supply component									
• Drainage component									
At completion (2003)						7.8%	n/a	n/a	n/a
• Water supply component								• 19.9%	• 39.5 @ 12%
• Drainage component								• 18.7%	• 5.1 @ 12%
[AsDB] Tonle Sap Rural Water Supply and Sanitation Sector Project	Rural Water and Sanitation / Health and social protection	Sep 2005	18.0	MRD	Active				
• Water supply						n/a	n/a	• 21.6 – 26.2% ******	n/a
• Sanitation								• 12.8 – 14.2%	
• Combined, plus technical assistance								• 19.5 – 23.9%	

Sources: *Project reports of the World Bank and Asian Development Bank.*

Notes: * *The average economic internal rate of return of 12 subprojects in different towns is estimated by defining economic benefits as comprising of direct use benefits, consumer surplus and cost savings. With 50 percent capital cost recovery, the average EIRR for the 12 towns is 1.50 percent (using a discount rate of 4 percent). These estimates do not include consumption of institutional and commercial/industrial consumers and the health benefits.*

** *Three villages were included in the sample evaluation.*

4. Binding Constraints

Poor infrastructure and support services. To have a thriving private-led agriculture sector takes more than having an entrepreneurial spirit, land, and manpower. Cambodia rural infrastructure has been under funded for years due to political instability and lack of finance. While 70 percent of the country's population is directly or indirectly dependent on agriculture activities, the yields are driven by weather, as only 17 percent of the cultivated land is currently irrigated. There is a clear need to break this weather dependence and have an efficient modern system of irrigation. In order to have such efficient system, a primary basic needs assessment should take place in order to survey the available hydro and land resources in the country. The issue is really whether it makes sense to continue building small irrigation facilities at the commune level, which might not be the best solution in the long run and might not be the most cost effective means of water management in terms of the scale. In order to spread irrigation across a wider territory, large scale schemes must be deployed, which essentially require a total harmonization of the eco-system with the forest and land management. This implies that such development must be approved based on careful hydro and environmental assessment under close collaboration of all the three ministries leading the sector: MAFF, MOWRAM and MRD.

Production technology and agriculture knowledge available to the farmers is limited, and most of these are engaged in subsistence farming using low-input, low-output techniques. This results in poor yields and low incomes. The lack of skills, market information and technical advice effectively make the rural farmer handicap.

Poor roads, transportation services and ports represent another formidable obstacle on the way of agriculture produce to markets, which drives the costs of agriculture products up. Given the fact that most of the agriculture goods are traded commodities and consumers always have a choice of importing the same products from neighboring countries, these transport costs absorb an unnecessarily high portion of the market value of most products, thus reducing the pay off to the farmer.

Availability and high cost of inputs. It has been reported that the availability and quality of agriculture inputs is far from the regional and international standards. The main constraints that farmers face are the quality and price of fertilizers, seeds, equipment and energy. Cambodia does not have the capacity to produce the agriculture inputs that farmers need, and most of these inputs are currently imported from the neighboring countries.

In case of fertilizer, only a handful of companies deal in the distribution of imported fertilizers, which are reportedly diluted and are of a sub-standard grade. To alleviate the agriculture inputs problem, the government must ensure that imported agriculture inputs and equipment do not face barriers in terms of taxes and import duties, and administrative hassle (approvals, permits, licenses, etc.). It is critical to let the competitive forces regulate this market, so that the farmers benefit from the increased supply of inputs and hopefully lower costs of acquisition of the inputs and equipment.

Government continued assistance is required for spread of quality seeds in the sector and to make sure that the farmers have an access to the latest available seed material that research labs produce.

Weak legal and regulatory framework. Cambodia is the case where the private agriculture development is very dependent not only on the public sector infrastructure availability but also on the legal and regulatory policies of the government. The main constraint for the public sector is the lack of effective coordination among the three ministries and lack of a single master-plan that would guide the long-term development of the sector. This impairs the ability of the three ministries to deliver the public sector services effectively. Weak enforcement of the existing regulations is definitely a reason for concern.

5. Recommendations

Resource Inventory and Needs Analysis Survey. From a brief analysis of the current situation at the various departments at both the MAFF and MOWRAM, it is clear that the decision-makers suffer a lack of detailed technical information of the natural resources in the country. The latest comprehensive hydro and forest surveys were taken 10-20 years ago and are largely obsolete by now. This is an activity that is crucial to effective functioning of the ministries, and donors can definitely help to overcome this problem. This has to be the first order of priority.

Sector Wide Planning and Institutional Framework. The present institutional organization is not the most effective form of managing the sector as the two ministries have overlapping functions. In addition, the Ministry for Rural Development (MRD) has an extensive involvement into the sector. There is a need to have a clear and effective division of powers and responsibilities among the bodies, and have a functional system of communication and cooperation among the ministries. While the priorities of each ministry talk about the same things, the actual programs lack harmonization of timing and inter-related activities among MAFF, MWRM and MRD.

Increase Resource Allocation to Agriculture. Given the importance of the sector in the economy of Cambodia, and dependence of population on the income from agro-activities, it is critical to increase the size and effectiveness of spending in the sector. A clear link between the sector goals and budgets must be established. The government should structure its additional spending on crucial public goods in key accessible geographical areas: irrigation, roads, flood control, fisheries R&D, production technology, and provision of extension services. Agriculture is very dependent on the liberal trade and macro policy, which has been favorably maintained by the government with minimum intervention. It is necessary to finalize a single long-term strategic plan with in regard to the sector that would set out the key priorities and direction for development in each field.

Capital Expenditure and Maintenance. The level of capital expenditure should be raised in order to achieve the desired increase in agricultural output and rural incomes. It is important have a well coordinated and comprehensive development plan that would guide the increased capital spending in the sector. Expenditure on maintenance of existing and new facilities must be taken seriously and responsibility should be taken in regard who will effectively carry out the routine and periodic maintenance activities. At the moment, the government spending on maintenance inadequate and is on an ad-hoc basis system of identification and evaluation exists to assist the decision-makers in regard to allocation of maintenance funds.

ROADS AND TRANSPORT

1. Importance of Road Transport. Road transport is the main means of commuting and freight hauling in Cambodia. The country has about 12,000 km of primary and secondary roads under the Ministry of Public Works and Transport (MPWT) and around 26,000 km of tertiary roads under the Ministry of Rural Development (MRD). The overall condition of the network is such that only a fraction of all the primary and secondary roads are in excellent or good condition, while most of the network is in poor or bad condition. Over a period 1998-2005, the government with the assistance of donors has made significant progress in terms of re-building its existing primary road network. It has been reported that all the national highways will be soon restored to a paved surface.

On the primary arterial network of national roads, about 90% of the 2,050 km length is paved or under construction, however 50% of these roads are already in poor condition and in need of rehabilitation. On the 9,100 km long secondary network of national and provincial roads, only 6% is paved and 33% has unreliable accessibility. Overall, about 20% of the national-provincial network of 11,100 km is paved, only 50-60% is considered in maintainable condition. The remainder requires rehabilitation or construction. On the tertiary rural road network length of 28,000 km, including urban roads, about 10,100 km or 38% has a gravel surface and is considered all-season accessible and maintainable.[17]

Cambodia has two rail lines with a total length of 637 km. Both the rail lines and the carriages are in dire need of replacement and repair. The RGC has committed itself to the participation in the planned Asean rail line from Singapore to Kunming, China. Of immediate concern to the government is beginning construction on a 48-km stretch of railway from Poipet town to Sisophon. Completing that section would link Cambodia's rail system to the Asean railroad, which means the government will face the US$ 100 million additional cost of improving the 338 km of dilapidated tracks from Sisophon to Phnom Penh, Sokhom Phekawanmony. In addition to that, an estimated US$ 300 million will be needed to build a new railroad linking Phnom Penh to the Vietnam border.[18]

At the moment, the bulk inland load of passenger and cargo is carried by road transport. The condition of the tertiary road network is known to be bad and many rural areas are frequently cut off the in the wet season. Floods have been severely damaging rural roads, most of which are un-engineered and un-maintained. While it is generally understood that the tertiary roads are the key to unlocking the rural potential of Cambodia, and often the only means of gaining access to markets, health and education centers. Slow progress has been made in restoring the rural road system. The agricultural sector has been pushed up to the top of the development agenda of the government, but little account is taken of the fact that transport costs often

[17] International Development Association, "Proposed Poverty Reduction Support Operation for Kingdom of Cambodia: Potential for Funding of Road Sector: Aide Memoire: Review Mission November 2005", Draft Final, 30-Nov-2005.

[18] *The Cambodia Daily*, WEEKEND Saturday, January 10-11 2004.

make up 5-20 percent of the market value of agriculture commodities. Lowering transport costs will have a direct impact on the incomes of rural farmers.[19]

2. Institutional Framework. Two ministries are in charge of the road network in Cambodia. The MPWT carries the formal responsibility for overall management and development of the transport sector: roads (except rural roads), road transport, railways, ports, inland water transport, coastal and international shipping and airport construction. Rural roads are defined as those carrying less than 50 vehicles per day, notwithstanding the absence of routine traffic counts. They come under the responsibility of MRD. Once traffic exceeds 50 vehicles a day, they are normally transferred to MPWT's secondary network. The MRD is responsible for rural development, including development and maintenance of rural/tertiary roads. Responsibility for air services are vested in the State Secretariat of Civil Aviation.

The MEF is heavily engaged in the selection of road rehabilitation and maintenance, and also in the process of disbursement, procurement and execution of road contracts. No system of project appraisal is used to decide which roads should be prioritorized for rehabilitation and expansion. Project selection is done almost entirely according to the perceived needs by the political leadership. The Ministry of Internal Affairs is responsible for the civil police, in which the Traffic Police are charged with enforcing traffic and road safety regulations. The Ministry of Land Management, Urban Planning and Construction is responsible, as the name implies, for land management and development, and regulating and building urban infrastructure.

3. Sources of Funds and Expenditure Management. There are two sources of inflow od funds into the sector: i) the government funds and ii) external assistance. The MEF exercises tight control over capital budget allocations and disbursements to the road projects. It has been reported that virtually all other capital flows for roads from the national budget are allocated and disbursed directly to the implementing agencies, whether provincial, military or private contractor, by MEF. These include capital projects nominally under MPWT's budget but effectively administered by MEF and funds allocated directly to provincial administrations and used for projects carried out by the Provincial and Municipal Public Works and Transport Departments (PPWTDs). That recurrent budget of MPWT covers the salaries, operating costs and social benefits of the provincial agencies. The capital expenditures are sourced from Chapters 50 of the budget and Chapter 51 (foreign aid), while the maintenance resources are channeled through Chapter 30.03. MEF also administers the proceeds of the fund for repair and maintenance of roads (FRMR), following decisions by the OPM on their allocation among projects. The only significant expenditures it now manages are those from foreign loan- and grant-funded projects.[20]

For the tertiary road network, MRD has more control over expenditures. Its budgets, once approved by MEF, provide a list of projects which are carried out with supervision from Provincial Offices of Rural Roads in the Provincial Departments of Rural Development. Capital funding comes from the allocations under the current budget, priority action program

[19] "Towards a Private Sector-led growth Strategy for Cambodia, Volume 1: Value Chain Analysis", The World Bank, 2003.

[20] Public Expenditure Review - Sector Paper: The Roads Sector, The World Bank, 2003.

(PAP), and foreign loans and grants, while maintenance is financed from the allocations through the roads fund.

The purpose of the FRMR is for the routine and periodic maintenance of national, provincial roads and other roads in the country. FRMR revenues are sourced from the additional tax comprising a levy imposed on gasoline and diesel, which are collected by the Department of Custom and Excise and deposited in the government account with the National Treasury. The MEF receives proposals from MPWT and provincial authorities, and undertakes a detailed inspection of each proposed project. The most recent FRMR budget (2005) allocated KHR 68 billion ($17 million) for implementation through five agencies: 30 percent for routine and periodic maintenance of national roads under Chapter 30.03 by MPWT; 10 percent for routine and periodic maintenance of rural roads under Chapter 13 by MRD; 5 percent for road maintenance and flood protection under Chapter 11 by MWRM; and 55 percent for rehabilitation and reconstruction under Chapter 30.03 by PPWD of MPWT.[21]

4. Public Expenditures on Roads. A major effort in rehabilitation of the national road network has been undertaken over the past decade. Over 1,000 km of the national roads have been rebuilt. National Road Rehabilitation and Reconstruction Program adopted by the RGC plans to restore all the single- and double-digit national roads by 2006, and the implementation is on schedule. The program aims at establishing proper road connections with the neighboring countries, as well as at interconnection of the main national cities. The second phase of the program will focus on the provincial and tertiary roads.

The current practice of project selection in the sector is such that different procedures are used to appraise and implement road projects, depending on the source of funds. It is reported that for major rehabilitation projects on primary/secondary networks funded by donors, a comprehensive system of project identification, preparation, monitoring and evaluation is carried out in accordance with the donor requirements. For rehabilitation funded from MPWT's own capital budget, whether channeled through MPWT's ministry or provincial allocations, projects are usually prepared by the PPWTDs. MEF makes the decisions about allocating the funds. There is no systematic process of project identification, preparation and evaluation over the network as a whole. MPWT tends to be involved only on an ad-hoc consultative basis.[22] Given the capital-intensive nature of road investment and commitment they entail for future outlays for maintenance, it is critical that modern project evaluation methods to be used to appraise and prioritize roads for rehabilitation and maintenance in Cambodia.

Table 3.5 presents the summary of government-financed expenditures in the sector, channeled through the two main ministries responsible for road building and maintenance: MPWT and MRD. It should be noted that apart from the rural roads, the budget of MRD also includes a number of other projects aimed at rural development. The combined spending by the two

[21] International Development Association, "Proposed Poverty Reduction Support Operation for Kingdom of Cambodia: Potential for Funding of Road Sector: Aide Memoire: Review Mission November 2005", Draft Final, 30-Nov-2005.

[22] Public Expenditure Review - Sector Paper: The Roads Sector, The World Bank, 2003.

ministries rose remarkably from only US$ 5.3 million in 1998 to US$ 49.1 million in 2004. The peak spending of US$ 58.5 million in 2002 reflects the massive Emergency Flood Damage Repair Program for repairing the damage caused by the floods in 2000. Also, in 2001 MRD initiated its plan for rehabilitation and maintenance of 21,195 km of tertiary roads, which is still ongoing.

Table 3.5: MPWT and MRD Budget, 1996-2005 (% of Treasury Executed Sector Spending)

MPWT and MRD	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
MPWT, US$ millions, constant 2005 prices	**7.5**	**7.4**	**3.7**	**8.1**	**20.6**	**25.4**	**40.9**	**29.3**	**28.2**	**26.9**
MRD, US$ millions, constant 2005 prices	**1.6**	**1.1**	**1.7**	**4.3**	**3.5**	**8.4**	**17.5**	**22.6**	**20.9**	**17.0**
MPWT and MRD, Total	**9.1**	**8.6**	**5.3**	**12.4**	**24.1**	**33.9**	**58.5**	**52.0**	**49.1**	**43.9**
MPWT and MRD, Share of Sector Spending	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
1-Ministry	**77%**	**82%**	**77%**	**84%**	**89%**	**90%**	**93%**	**91%**	**92%**	**90%**
Sub-Total Current Expenditure	**15%**	**16%**	**22%**	**12%**	**22%**	**18%**	**8%**	**8%**	**7%**	**13%**
Ch. 10 : Salaries and Allowances	4%	6%	9%	4%	2%	2%	2%	2%	2%	2%
Ch. 11 : Operating Costs	4%	4%	6%	4%	5%	5%	3%	3%	2%	6%
Ch. 13 : Special programme agreements	0%	0%	0%	0%	0%	2%	3%	3%	3%	4%
Ch. 30 : Economic transfer payments	7%	6%	7%	4%	14%	7%	0%	0%	0%	1%
Ch. 31 : Social transfer payments	0%	0%	0%	0%	0%	2%	0%	0%	0%	0%
Sub-Total Capital Expenditure	**61%**	**66%**	**55%**	**72%**	**67%**	**72%**	**85%**	**84%**	**85%**	**78%**
Ch. 50.1 : Construction and Equipment	55%	49%	55%	72%	67%	61%	72%	64%	53%	57%
Ch. 50.2 : Counterpart on externally financed	6%	17%	0%	0%	0%	11%	13%	14%	18%	15%
Ch. 50.3 : Investment by foreign funds	0%	0%	0%	0%	0%	0%	1%	6%	14%	5%
9-Provinces	**23%**	**18%**	**23%**	**16%**	**11%**	**10%**	**7%**	**9%**	**8%**	**10%**
Sub-Total Current Expenditure	**17%**	**17%**	**23%**	**16%**	**11%**	**10%**	**7%**	**9%**	**8%**	**10%**
Ch. 10 : Salaries and Allowances	11%	12%	17%	8%	4%	3%	3%	3%	3%	4%
Ch. 11 : Operating Costs	6%	5%	6%	8%	7%	6%	4%	5%	4%	5%
Ch. 31 : Social transfer payments	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Sub-Total Capital Expenditure	**6%**	**2%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**
Ch. 50.1 : Construction and Equipment	6%	2%	0%	0%	0%	0%	0%	0%	0%	0%

Source: Estimates based on MEF TOFE.

As the volume of capital spending increased over time, both ministries recorded a reduction in the share of salaries in the budget. The salaries and allowances at the ministerial level declined from 9 percent of the budget in 1998 to only 2 percent in 2004, while the salaries and allowances in provinces decreased from 17 percent of their budgets to 3 percent over the same period. The operational costs at both ministerial and provincial level have stayed stable as a share of the total budget over 1998-2004.

The institutional allocation of funds between the main ministries and provincial bodies in 1998 was such that the central ministries were absorbing 77 percent of the combined budget thus leaving the provincial counterparts 23 percent to spend. Because of the increased capital flows into the roads sector the overall size of expenditures rose over time. The two central ministries have more execution capacity as compared to the provincial agencies and most of the additional capital flows was handled by the main ministries, which pushed their share of the total budget upward.

In terms of capital spending carried out by the two ministries, Table 3.6 presents a detailed account of the capital expenditure by chapter. There is no clear trend in the amount of capital investment financed from internal sources and categorized under Chapter 50.1. Over a period 1999-2004, the construction and equipment spending by MPWT has been as high as US$ 28.1 million in 2002 and as low as US$ 5.2 million in 1999 and US$ 9.9 million in 2004. The project financed with partial or complete funding from external sources are presented in Chapter 50.2 and 50.3, and the total amount has been also fluctuating over time, driven by the number and size of the projects undertaken by donors. The MPWT allocation for maintenance of national roads from Chapter 30.03 has been steadily increasing from US$ 4.0 million in 2002 to US$ 12.6 million in 2004. In 2005 the FRMR budget will allegedly have US$ 17 million to spend on maintenance activities for all sectors. The resource need for the maintenance of the existing roads network has been estimated US$ 18 million a year but given the large size of roads network in Cambodia, even this figure seems to be underestimated.[23] The 2005 FRMR budget does not come close even for the needs of the roads maintenance, not mentioning infrastructure in other sectors.

Table 3.6: MPWT and MRD Capital Budget, 1999-2005 (US$ millions, constant 2005 prices)

MPWT	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005A**
No. of Projects	n/a	n/a	n/a	59	44	31	n/a
Ch. 50.1: Construction and equipment	5.2	13.5	14.8	28.1	14.9	9.9	15.6
Ch. 50.2: Counterpart on externally financed	0.0	0.0	3.1	6.6	5.9	8.1	5.4
Ch. 50.3: Investment by foreign funds	0.0	0.0	0.0	0.3	2.7	5.9	2.2
Ch. 30.03: Maintenance budget	n/a	n/a	n/a	4.0	11.4	12.6	10.4
Total	**5.2**	**13.5**	**18.0**	**39.0**	**35.0**	**36.6**	**33.5**
MRD							
No. of Projects	n/a	n/a	n/a	21	52	51	n/a
Ch. 50.1: Construction and equipment	3.3	1.2	4.6	11.0	15.8	15.1	9.7
Ch. 50.2: Counterpart on externally financed	0.0	0.0	0.4	0.7	0.8	0.5	1.1
Ch. 50.3: Investment by foreign funds	0.0	0.0	0.0	0.0	0.0	0.5	0.2
Ch. 30.03: Maintenance budget	n/a	n/a	n/a	0.0	0.02	0.02	0.12
Total	**3.3**	**1.2**	**4.9**	**11.7**	**16.7**	**16.1**	**11.2**

Source: Estimates based on MEF TOFE.

As mentioned earlier, the capital expenditures carried out by the MRD are driven by, but not limited to, rural road improvement projects. As Table 3.6 indicates, the internally-funded projects from Chapter 50.1 rose from a mere US$ 3.3 million in 1999 to US$ 15.1 million by 2004. The size of spending involving external funds has not increased as much as at the MPWT. The allocation of maintenance funds from Chapter 30.03 has been very limited over

[23] International Development Association, "Proposed Poverty Reduction Support Operation for Kingdom of Cambodia: Potential for Funding of Road Sector: Aide Memoire: Review Mission November 2005", Draft Final, 30-Nov-2005.

the past years. It is clear that the maintenance funds available for rural road network are inadequate.

5. Project Returns. The samples of project returns presented in Table 3.7 and 3.8 were obtained from the appraisal documents of the WB and AsDB. As the results indicate, the economic returns of road rehabilitation activities are mostly in excess of 20 percent, which exceed by far the economic opportunity cost of capital used to finance the projects. There is a substantial economic benefit in providing connectivity among the social and economic centers in the country, and the road users stand to gain a significant surplus as a result of such road improvement projects. The reduction in transportation costs provides an incentive to the economic agents to expand their activities.

Table 3.8 looks specifically at a number of projects in rural areas, carried out by the MRD. While there is a degree of variability in the project returns for rural roads rehabilitation, it is obvious that such improvements earn a return in excess of the economic opportunity cost of capital.

6. Binding Constraints

Lack of technical involvement in roads planning and management. The existing selection procedures decimate the role of both MWPT and MRD since the load of project selection is carried by MEF rather than by the two relevant ministries. As a result, a little room is left for proper coordination of the network rehabilitation efforts and maintenance decisions. The technical expertise of the line ministries does not find an application in such environment, which limits the ability to optimize the effectiveness of road expenditures. Many countries have once experienced similar circumstances but since moved to a system where an operationally independent road agency acts on behalf of the government to manage the roads network in the most efficient manner. The present institutional framework where the national roads belong to MWPT and rural roads to MRD is obviously not the best arrangement that allows for a holistic nation-wide planning and management of the road network.

Limited maintenance funding and coordination. As a consequence of the weak system of planning and management for roads, the current expenditures are heavily biased towards rehabilitation, flood damage repair, and extension activities and very little is channeled to the routine and periodic maintenance of the network. This effectively results in premature loss of assets that otherwise could have been prevented. The overall outcome is a sub-optimal allocation of limited public resources.

Absence of transparent project selection system. The current selection procedure is not based on transparent selection criteria and its linkage to the sector priorities is not known. The potential projects with the highest economic return are not necessarily the ones that are selected for funding. Such practices discourage an efficient management of the road network, as there is no coherent rationale for selection of projects. There is sufficient technical expertise at MWPT and MRD to work out a single set of selection criteria that would be used to guide the upgrading, rehabilitation and maintenance decisions for all types of roads.

Table 3.7: Project Returns in Road and Transport

Donor / Project	Sector(s)	Approval Date	Amount (US$ million)	Executing Agency	Status	FIRR (%)	FNPV (US$ million)	EIRR (%)	ENPV (US$ million)
[WB] Road Rehabilitation Project	Roads and highways / Law and justice and public administration	Mar 1999	45.3	MPWT	Active	n/a	n/a	31.9%	52.3 @ 12%
• SR 1 Airport Access Road								• 16.6%	• 0.3 @ 12%
• SR 2 Access Road Angkor Wat								• 35.3%	• 5.1 @ 12%
• NR6-1 Airport Rd. to Siem Reap								• 30.8%	• 4.0 @ 12%
• NR6-2 Siem Reap to Psar Lieu								• 41.9%	• 3.0 @ 12%
• NR6-3 Psar Lieu to Roluos Rd.								• 24.2%	• 2.6 @ 12%
• NR64 Roluos Rd. to Damdek								• 30.6%	• 7.9 @ 12%
• NR6-5 Damdek to Kampong Tom Border								• 31.4%	• 17.5 @ 12%
• NR3-1 Veal Rinh to Kampot Border								• 36.3%	• 11.8 @ 12%
[WB] Provincial and Rural Infrastructure Project	Roads and highways / Law and justice and public administration	Sep 2003	20.0	MPWT	Active	n/a	n/a	35%	14.2 @ 12%
[AsDB] Siem Reap Airport Project	Civil Aviation	Dec 2004	13.7	State Secretariat of Civil Aviation	Closed		n/a		n/a
• At appraisal (1996)						• 13.8%		• 21.6%	
• At audit (2004)						• 14.9%		• 23.9%	

Sources: Project reports of the World Bank and Asian Development Bank.

Table 3.8: Returns in Rural Development / Multi-sector Projects

Donor / Project	Sector(s)	Approval Date	Amount (US$ million)	Executing Agency	Status	FIRR (%)	FNPV (US$ million)	EIRR (%)	ENPV (US$ million)
[WB] Rural Investment and Local Governance Project • Rehabilitation of rural transportation infrastructure • Rehabilitation and construction of communal irrigation schemes • Improvements in supply of potable water	Sub-national government administration / Law and justice and public administration	Apr 2003	22.0	SEILA	Active	n/a	n/a	• 84% • 98% • 14%	n/a
[AsDB] Greater Mekong Subregion: Mekong Tourism Development Project • Siem Reap Wastewater Management • Access Road Improvement to Genocide Memorial • Rattanak Kiri Airport Improvement • Stung Treng Airport Improvement • Access Road Improvement to the Kwangsi Water Falls • Access Road Improvement to Konglor Cave • Louang Namtha Airport Improvement • An Giang Tourist River Piers Improvement • Sam Mountain Environmental Improvement • My Tho Tourist River Pier Improvement • Tien Giang Environmental Improvement • Pro-poor Community-Based Ecotourism	Tourism / Poverty intervention / Economic growth, and regional cooperation	Nov 2002	15.6	MOT	Active	n/a	n/a	• 33.4% • 25.1% • 13.3% • 14.2% • 21.4% • 15.3% • 16.6% • 17.7% • 27.0% • 31.5% • 23.6% • 19.3%	• 7.39 @ 12% • 1.54 @ 12% • 0.65 @ 12% • 0.39 @ 12% • 2.84 @ 12% • 0.95 @ 12% • 0.6 @ 12% • 0.52 @ 12% • 7.21 @ 12% • 3.69 @ 12% • 1.41 @ 12% • 0.18 @ 12%
[WB] Land Management and Administration Project	Central government administration / Law and justice and public administration	Feb 2002	24.3	MLMUPC	Active	22%	15.4 @ 10%	n/a	n/a
[WB] Cambodia Trade Facilitation and Competitiveness	Industry and trade / Law and justice and public administration	Jun 2005	10.0	MOC	Active	144%	n/a	216%	44.0 @ 12%

Sources: Project reports of the World Bank and Asian Development Bank.

Contracting and procurement. It has been reported that the present procedures do not provide for transparent selection of contractors, which is bound to result in irregularities in the project procurement and add unnecessary inefficiency to public funds management. The selection is currently not open to any transparent bidding. The RGC has been using the absence of clear selection regulations to employ the military corps of engineers to carry out road contracts.

7. Recommendations

Operationally independent roads agency. To effectively manage the existing road network, the technical knowledge of the line ministries must be continuously employed to carry out the daily maintenance tasks and to plan for the future rehabilitation and expansion works. As international practice shows, the best arrangement is to setup an independent body that would manage the available budget according to the needs of the sector. Ideally, the agency should combine both the national and rural networks, and be responsible for planning, management, rehabilitation, maintenance and procurement of all road-related activities in the country.

Project selection system. To assist the task of an independent roads agency, its staff should be adequately trained to carry out the project selection not only at technical level but also at the level of economic assessment for the country. That would ensure the optimal selection of projects and maximize the efficiency of public spending on the roads.

Maintenance funding. The present system does not provide for adequate ongoing funding of routine and periodic maintenance of the existing network. An additional source of funding must be available for this purpose on a permanent basis.

EDUCATION SECTOR

1. Institutional Framework. The Ministry of Education, Youth and Sports (MEYS) is in charge of primary, secondary, high and special education in Cambodia. The ministry operates a provincial education office in each of the provinces, and consequently there are a number of district education offices (DEO) reporting to the corresponding PEO. Every year about 3 percent of the total budget of the MEYS is directed towards the youth and sports activities, which are here excluded from the education sector expenditures (Annex A).

2. Sources of Funds and Expenditure Management. There are three sources of funding to the sector: i) the government budgets, ii) external assistance and iii) private contributions. The discussion in this section closely follows the government budget allocation on the education sector and does not include the education expenditures made directly by the donors. In terms of government expenditures, the following should be noted. Starting with 2000, RGC has undertaken a Priority Action Program (PAP) aimed at the priority sectors. Education has greatly benefited from PAP allocations, which came as an additional flow of funds, mainly under Chapter 13 (special programme agreements). The PAP funding has been incremental to the normal budget to the sector. Referring back to Table 2.2, one could see that the treasury executed spending on education, including PAP funding, increased from 0.9 percent of GDP in 1998 to 1.5 percent of GDP in 2004.

Since its introduction PAP program has been very important for school funding in Cambodia. Specifically, PAP 2.1 is the main source of public funding for schools operating expenditures and is the most widespread and predictable source of funding as it provides more than a quarter of all government funding to the sector. All primary schools receive PAP 2.1 funds, which is a formula-based grant. For primary schools in 2003/04 fiscal year, the fixed per-school component was Riel 500,000. The variable component was based on an allocation of Riel 6,000 per student. Another sizeable fragment of PAP funding is PAP 2.2 which is intended for teachers conducting remedial teaching during summer vacation. In relative terms, PAP 2.2 funding was only 22 percent of PAP 2.1 allocation. In addition to these two, a significantly smaller fraction of the priority funding was given to PAP 7.1 which is directed towards the provision of school textbooks.[24]

All the government expenditures, with the exception of PAP funds, are implemented following a highly centralized process. The education budget of MEYS is basically planned, executed, and audited through a process in which the MEF, National Treasury, and the provincial treasuries play central and controlling roles. The planning for PAP funding is undertaken following a bottom-up approach, where the district education offices submit funding requests to the provincial authorities which, in turn, consolidates the requests and submits them to the central government, where the PAP budgets are finally prepared. The implementation of the PAP budget is relatively decentralized or, more specifically, de-concentrated, compared to the traditional budget execution system. This is because MEF no longer acts as the central player and delegates most of the functions to MEYS and its provincial and district offices. To undertake these additional tasks the capacity of provincial

[24] "Public Expenditure Tracking Survey in Primary Education", The World Bank, 2005.

education offices and district education offices has been upgraded, both in terms of training and support equipment.

The external assistance to the sector has also been very important, but is somewhat declining over time because of increased government participation in the sector. Foreign aid comes to the sector through various NGOs and directly from organizational donors. There is a wide variation in terms of type of donations. Some assistance comes as infrastructure improvements while some is directed at school supplies, and even for the provision of food. In 1998 the development partners contributed an amount equivalent to 1.9 percent of GDP to education but by 2003 this reduced to 1.7 percent of GDP. The Public Expenditure Tracking Survey (PETS) in primary education indicated that 45 percent of schools, covered by the survey in 2003/04, reported they receive donations from NGOs/donors, with an average size of such donation of being Riel 28.2 million.[25] Some 44 percent of these schools who received donations did not know the monetary value of the assistance.

In addition to these two sources, the private contributions to schools have been a daily practice in Cambodia. Much of such assistance comes as in-kind contributions, and given the poor record-keeping capabilities and reporting standards, the exact magnitude of assistance from parents, community and other sources can not be known. The same survey reports that 48 percent of schools receive contributions from parents and the community, with an average size of such contribution of Riel 5.0 million. Out of the schools that receive such assistance, 23 percent do not know the monetary value of donations. The survey also asked the respondents about other sources of assistance, and 75 percent of schools reported they received such donations. The average size of such donations was Riel 12.8 million, and 27 percent of these schools who received donations did not know their monetary value.[26]

3. Public Expenditures on Education. Table 3.9 presents the allocation of MEYS education budget during 1996-2005 in constant 2005 prices. This clearly shows that the size of budget increased from US$ 28.0 million in 1998 to US$ 84.2 million in 2004. The PAP funding (Chapter 13), which was introduced in 2000, accounted for US$ 22.5 million in 2004.

During the 1990s, the proportion of the government budget allocated to education was low. In most countries of the region, education was allocated well over 10%, and in a few countries the figure exceeded 20% (Bray, 2004). Further, in Cambodia actual expenditures on social services were often lower than the budgeted amounts. Starting from 1998, this trend was radically reversed with a significant increase in public resources devoted to education, particularly recurrent expenditures in the basic education sector. PAP, launched on a pilot basis in 10 provinces in 2000, shifted the focus of education policy towards factors increasing the reception of education services by the people. These measures included the removal of registration and other school fees, grants to schools for pre-determined operational expenditures to replace school charges previously imposed on households (PAP 2.2), and remedial classes (PAP 2.2). The PAP primary education package has played an important role in the improvement of primary enrollment rates.[27]

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[25] Ibid, pg 31.
[26] Ibid, pg 31.
[27] Ibid, Chapter 5.

Table 3.9: MEYS Budget, 1996-2005 (US$ millions, constant 2005 prices)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Total (US$ millions, constant 2005 prices)	**26.1**	**26.0**	**28.0**	**41.9**	**46.3**	**61.1**	**76.8**	**80.2**	**84.2**	**85.6**
1-Ministry	**4.4**	**4.2**	**4.3**	**9.7**	**10.1**	**16.4**	**27.1**	**28.0**	**32.3**	**29.4**
Sub-Total Current Expenditure	**4.2**	**3.4**	**4.2**	**8.0**	**9.0**	**11.9**	**27.0**	**26.7**	**29.9**	**27.9**
Ch. 10: Salaries and Allowances	0.7	0.9	1.0	1.3	1.4	1.0	1.2	1.4	1.4	0.7
Ch. 11: Operating Costs	3.3	2.2	3.0	6.6	7.4	6.7	5.4	4.5	5.8	3.2
Ch. 13: Special programme agreements	0.0	0.0	0.0	0.0	0.0	3.9	20.2	20.6	22.5	23.7
Ch. 31: Social transfer payments	0.1	0.3	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.3
Sub-Total Capital Expenditure	**0.3**	**0.8**	**0.1**	**1.6**	**1.1**	**4.5**	**0.1**	**1.3**	**2.4**	**1.6**
Ch. 50.1: Constructions and Equipment	0.1	0.3	0.1	1.6	1.1	2.9	0.1	1.1	0.7	0.4
Ch. 50.2: Counterpart on externally financed	0.1	0.5	0.0	0.0	0.0	1.6	0.0	0.2	1.4	0.8
Ch. 50.3: Investment by foreign funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.4
9-Provinces	**21.7**	**21.8**	**23.7**	**32.2**	**36.2**	**44.7**	**49.7**	**52.2**	**52.0**	**56.1**
Sub-Total Current Expenditure	**21.5**	**21.8**	**23.7**	**32.2**	**36.2**	**44.7**	**49.7**	**52.2**	**52.0**	**56.1**
Ch. 10: Salaries and Allowances	18.1	18.9	21.2	29.4	32.8	35.3	42.9	46.2	46.2	51.5
Ch. 11: Operating Costs	3.1	2.5	2.2	2.5	1.7	5.1	5.9	5.3	4.9	3.3
Ch. 13: Special programme agreements	0.0	0.0	0.0	0.0	0.7	3.6	0.0	0.0	0.0	0.0
Ch. 31: Social transfer payments	0.3	0.3	0.3	0.4	0.9	0.7	0.9	0.8	0.9	1.4
Sub-Total Capital Expenditure	**0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Ch. 50.1: Constructions and Equipment	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ministry: Ratio of Operating Costs to Salaries and Allowances	4.8	2.4	2.9	5.0	5.3	6.4	4.4	3.1	4.3	4.7
Provinces: Ratio of Operating Costs to Salaries and Allowances	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Source: Estimates based on MEF TOFE.

Most of all funds allocated to education (PAP and non-PAP) go to funding of recurrent expenditures both at the ministerial and provincial levels. As Table 3.9 indicates, the spending on salaries and allowances (Chapter 10) at the ministry, has fluctuated over time within US$ 1.0-1.4 million over the period 1998-2004. The operating costs (Chapter 11) initially rose from US$ 3.0 million in 1998 to US$ 7.4 million in 2000, but then declined to US$ 5.8 million by 2004. The provincial offices have been processing the bulk of salary payments for the teachers, and its Chapter 10 expenditures experienced a drastic increase from US$ 21.2 million 1998 to US$ 46.2 million in 2004. The operating costs in provinces also rose from US$ 2.2 million 1998 to US$ 4.9 million in 2004.

The following pattern of operating costs (Chapter 11) allocation was recorded in primary schools in 2003: sectoral goods - 40.6 percent; administration of non-furniture - 16.9 percent; expenditures paid through admission fees - 12.5 percent; vehicle costs and maintenance - 9.5 percent; office stationery and supplies - 8.3 percent; equipment and movable assets - 6.8 percent; telephone, reception, public events - 5.4 percent.[28] Table 3.9 shows that the ratio of operating costs to salaries and allowances at the provincial level remained fairly constant over time about 10 percent of salaries and allowances. At the ministerial level this ratio increased

28 Ibid, Chapter 4.

from 2.9 in 1998 to 6.4 in 2001 and then experienced a period of reduction to 4.3 by 2004. Most of all supplies are purchased centrally at the ministry level while the teachers' salaries are paid by provincial departments.

Funds allocated through PAP 2.1 channel (most of Chapter 13 spending) can only be spent on basic teaching materials, sports, small repairs and other small expenses incurred by schools following parameters: i) basic teaching materials - at least 30 percent; ii) sports, arts, crafts, agricultural activities - at most 15 percent; others (transportation, reception, etc.) - at most 7 percent; small repairs, furniture, school environment upgrading - not specified.

Capital spending at both ministerial and provincial levels is small as compared to the size of recurrent expenditures. Funding from own resources (Chapter 50.1) rose from a mere US$ 0.1 million 1998 to US$ 2.9 million in 2001 but then again declined to US$ 0.7 million by 2004. This is explained by relatively few large-size infrastructure improvements implemented, which drive the capital budget. The same erratic pattern is observed in terms of counterpart financing (Chapter 50.2) which bounced over time. It is not clear how the capital allocation relates to the PAP funding allocation.

4. Critical Issues

Procurement. The fiduciary risk associated with public procurement process is high due to weaknesses in the existing regulatory framework, low capacity, high informality and corruption. The same risk exists at both provincial and district levels. Also, the lack of alternative supply channels may preclude the operation of an efficient bidding system.

Institutional and Personnel Capacity. Capacity poses a major constraint on budget implementation. According to the IFAPER (WB and ADB, 2003) and PETS: Primary Education (WB, 2005), the rapid expansion of budget expenditures brought to light concerns on the capacity of officers, especially in budget preparation, costing, accounting records and reports, financial control procedures and control systems.

Infrastructure Adequacy. The issue of infrastructure adequacy arises given the large additional spending on education at all levels, and the nature of the activities where a lion's share of the budget is channeled to recurrent expenditure. The question is whether the existing school infrastructure and related maintenance funding is sufficient to keep up the pace of education improvements. It is important that the capacity of infrastructure does not eventually become a bottleneck in the system.

Supporting Facilities. As the inflow of funding increased to the sector, there is a need to provide an efficient monitoring and control of the activities undertaken with the additional funds. Despite recent improvements, office equipment and supplies, including computers and photocopiers, that are necessary for the preparation of various budget documents are inadequate at district offices and schools.

HEALTH SECTOR

1. Institutional Framework and Sources of Funds. The Ministry of Health (MOH) is in charge of sector planning, coordination and management. The ministry coordinates the activities of 24 provincial health departments. It is known that there are three main sources of funds to the sector: i) government funds, ii) external aid, and iii) private contributions. The relative importance of these sources is such that private contributions account for 72 percent of the total expenditure, foreign aid covers 19 percent, and public funding is the remaining 9 percent of the total sector spending.[29] Table 2.2 confirms that the treasury executed spending was equal to 1.0 percent of GDP in 2003, while the external assistance was 2.0 percent of GDP. The analysis that follows is focused on the expenditures that are executed by the government.

Since 1999 when healthcare became one of the top priorities of the RGC, there a number of improvements have been witnessed. The infant and child mortality rates have both declined along with the maternal mortality ratio. The programs undertaken by the MOH in collaboration with donors and NGOs managed to reduce the total fertility rate in the country, and somewhat improved the nutritional status among children and women.

During the past two years since the health sector reform, there has been the development of a Health Strategic Plan, and an Implementation Framework for the Strategic Plan. The MOH has introduced the new planning process to all the provincial health departments. The planning process now involves not only the provincial and ministerial bodies but also the actual health centers and referral hospitals to develop the plan and budget according to the needs of communities. The whole budget planning has changed from the complete top-down approach to a system where a 50-50 approach is employed. These reform measures helped to develop a more effective and efficient health system which slightly reduced the household health expenditures, especially among the poor. In 2002 the procurement process was changed from a monopoly to a competitive tender, and annual savings of US$ 4 million was expected in 2003.

2. Public Expenditures. Table 3.10 present the allocation of budget funds of the MOH in constant 2005 prices. The total spending in the sector increased substantially over the period. In 1998 the MOH budget stood at US$ 12.4 million while it reached US$ 59.7 million in 2005. Interesting enough, the additional funding that was given to the sector by the RGC was spent on recurrent expenditures. At the bottom of table, a ratio of the total recurrent expenditures to total capital expenditures is estimated. This clearly shows that the government has spent very little on the health infrastructure and all the new funding under the priority action programs was directed towards personnel, medical supplies and some critical maintenance. In 2001 current expenditures reached 93 percent of the total expenditures, while over the period 1996-2004 they have always been above 96 percent, and as high as 100

29 Policies, Expenditures and Outcome in Health Sector, Presentation to National Workshop on Integrated Fiduciary Assessment and Public Expenditure Review (WB), Cambodia, 2003.

percent of the total budget in 1998 and 2000. In fact, some of infrastructure spending was undertaken by donors' spending in the sector, but the question arises whether the infrastructure provision and maintenance funding have been adequate to appropriately complement the large enhancement of recurrent expenditures.

Table 3.10: MOH Budget, 1996-2005 (US$ millions, constant 2005 prices)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
MOH	**13.9**	**16.9**	**12.4**	**34.6**	**29.0**	**37.1**	**46.4**	**48.1**	**50.6**	**59.7**
1-Ministry	**8.5**	**12.1**	**8.8**	**29.0**	**20.1**	**25.5**	**30.8**	**31.4**	**35.2**	**40.6**
Sub-Total Current Expenditure	**8.3**	**9.2**	**8.7**	**15.1**	**20.0**	**24.5**	**29.2**	**30.4**	**34.2**	**39.2**
Ch. 10: Salaries and Allowances	0.7	0.9	0.7	0.8	1.0	0.9	1.8	1.2	1.4	1.7
Ch. 11: Operating Costs	7.4	8.0	7.8	13.3	17.2	15.9	18.9	20.1	22.9	26.5
Ch. 12: Subsidies for provincial administration units	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.2	1.6	1.9
Ch. 13: Special programme agreements	0.1	0.3	0.1	0.8	1.6	7.6	8.5	7.8	8.3	9.0
Ch. 31: Social transfer payments	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.1
Ch. 32: Transfer to international organizations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sub-Total Capital Expenditure	**0.2**	**2.9**	**0.1**	**13.8**	**0.1**	**1.0**	**1.6**	**1.0**	**1.0**	**1.4**
Ch. 50.1: Constructions and Equipment	0.1	2.4	0.1	13.8	0.1	0.1	0.4	0.5	0.7	1.1
Ch. 50.2: Counterpart on externally financed	0.1	0.5	0.0	0.0	0.0	0.9	1.1	0.3	0.3	0.2
Ch. 50.3: Investment by foreign funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.1
9-Provinces	**5.4**	**4.7**	**3.6**	**5.6**	**8.9**	**11.5**	**15.6**	**16.7**	**15.4**	**19.2**
Sub-Total Current Expenditure	**5.4**	**4.7**	**3.6**	**5.6**	**8.9**	**11.5**	**15.6**	**16.7**	**15.4**	**19.2**
Ch. 10: Salaries and Allowances	2.2	2.3	2.2	2.5	2.9	3.0	4.6	4.8	4.8	6.1
Ch. 11: Operating Costs	3.1	2.4	1.3	3.0	5.1	4.6	5.2	5.6	5.0	6.2
Ch. 13: Special programme agreements	0.0	0.0	0.0	0.0	0.8	3.9	5.7	6.2	5.5	6.6
Ch. 31: Social transfer payments	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.2
Sub-Total Capital Expenditure	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Ministry: Ratio of Operating Costs to Salaries and Allowances	9.9	8.4	11.0	16.5	17.1	17.7	10.7	16.7	16.5	15.7
Provinces: Ratio of Operating Costs to Salaries and Allowances	1.4	1.0	0.6	1.2	1.8	1.5	1.1	1.1	1.0	1.0
Ratio of Sub-Total Current to Total Expenditure	99%	83%	99%	60%	100%	97%	97%	98%	98%	98%

Source: Estimates based on MEF TOFE.

The total expenditure on salaries and allowances (Chapter 10) significantly increased both at the ministerial and provincial level. At the ministry level, the salaries were raised from US$ 0.7 million in 1998 to US$ 1.7 million in 2005, while the provinces witnessed a growth from US$ 2.2 to 6.1 million over the same period. The increase in spending was even more apparent in operational costs (Chapter 11). The ministry reported that it spent US$ 7.8 million in 1998 and US$ 26.5 million in 2005, and provinces processed US$ 1.3 million in 1998 and US$ 6.2 million in 2005. The PAP funding that was channeled to the sector through Chapter 13 was insignificant before 1999, but by 2004 it approached a figure of US$ 13.8 million which is about 27.3 percent of the total MOH budget.

The ratio of operating costs to salaries and allowances at the bottom of Table 3.10 indicates that at the provincial level, there was a period of operating costs increase which started with a ratio of 0.6 times in 1998 and ended with a ratio 1.8 times in 2000. Since then, the provincial ratio reduced to a level of 1.0 times, i.e. the operating costs just match the salaries. At the ministerial level, a clear increasing trend is observed. In 1998 the ratio stood at 11.0 times while the same ratio is 15.7 times in 2005. The high ratio of operating costs at the ministry level is a reflection of the centralized procurement system for inputs required to provide health services.

3. Project Returns. Table 3.11 presents the expected project outcomes at the time of project assessment of two projects undertaken by the Asian Development Bank and World Bank. While both projects report positive NPVs and acceptable rates of return, it is difficult to generalize sector wide issues based on these two projects. It is, however, clear that given the large need for basic medical services, especially in rural areas, any sensible improvement is likely to generate a high economic return.

Table 3.11: Project Returns in Health Sector

Donor / Project	Sector(s)	Approval Date	Amount (US$ million)	Executing Agency	Status	FIRR (%)	FNPV (US$ million)	EIRR (%)	ENPV (US$ million)
[AsDB] Health Sector Support Project	Health / Human development	Oct 2002	20.0	MOH	Active	n/a	n/a	27%	57.7 @ 14%
[WB] Health Sector Support Project	Health / Finance	Dec 2002	27.0	MOH	Active	n/a	n/a	17%	45.0 @ 3%

Sources: Project reports of the World Bank and Asian Development Bank.

4. Conclusion

The large increase in funding for the health sector since 1999 has had a positive impact on the health status and indicators of the country. The question that remains whether the expenditures are being made in the most cost-effective manner. As development partners are heavily involved in the financing of many of these activities and they are being monitored very closely. However, this does not apply to the health sector expenditures being financed out of the government own resources. Given the current procurement practices, considerable scope exists for improving the allocation of expenditures through case-analysis of what are and are not effective ways of expanding the health system.

ELECTRICITY SECTOR

In our study of the constraints to growth in Cambodia, the undeveloped state of the electricity sector is an issue that has been identified time and time again. It is something that inhibits the growth of almost all the economic sectors. The electricity component of the Energy Sector Strategy Review gives a very clear picture of the problems facing the sector and at the same time the opportunities for investment in the sector.[30]

If the manufacturing exports sector is to expand rapidly it must have access to electricity at competitive prices. At the present time Cambodia has some of the highest electricity rates in the world, with retail tariffs as high as US$ 20 cent/kwh. Self generation factory by factory results in a very inefficient system for meeting the electricity needs of industry. The electricity sector needs to have a strategic plan for its efficient and effective development. This will take time, however, to carry out. In the mean time there are many investments in generation, transmission and distribution that would be compatible with any long term expansion plan and at the same time have very substantial economic and financial rates of return.

For example, some of the generators operating in the present electricity system have fuel costs as high as US$ 11.27 cent/kwh, while other new ones have costs of US$ 6.64 cent/kwh, a difference of US$ 4.63 cent/kwh. Suppose the investment cost of new generation is US$ 400.0 per kw of installed capacity, and these generators run for 2,000 hours a year (load factor of less than 0.25.[31] Hence, the fuel savings would be worth US$ 92.6 per year. If the rate of depreciation of this plant were 3 percent a year, then the annual depreciation charge would be approximately US$ 12.0 per year. That leaves US$ 80.6 = 92.6 – 12.0 as the net return (assuming other costs are the same on the old and new plants) on an investment of US$ 400.0 per kw of capacity. This represents a real rate of return of slightly more than 20 percent a year, just from fuel savings alone.

In addition, the new generator would be able to run more hours than the old one, earning additional income from the incremental energy that would be more than the fuel costs of generation, hence, increasing the financial rates of return above the real rate of 20 percent. In a situation where getting access to the public supplies of electricity is often not possible, the economic returns from the expansion of electricity supply is likely to be substantially higher than the financial returns that are derived from the tariffs charged for the additional electricity supplied. Hence, the real rate of return of such an investment to replace existing inefficient generators is almost certain to be substantially higher than a real return of 20 percent a year.

In such an electricity system, there is likely to be many more investments in both generation and distribution where the rate of return is far above the cost of capital to the sector. While a Master Plan for the electricity system is being prepared, such high return investments should be identified and implemented to strengthen and expand the existing electricity system.

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[30] "Energy Sector Strategy Review: Issues Paper", The World Bank, 2005.
[31] Ibid., p. 39.

Table 3.12 presents a summary of known projects that reported an estimate of rates of return in the electricity sector. As one could see, the exhibit displays a wide range of estimates that differ from project-to-project and by timing of assessment. The methodologies used to derive these rates of return would also differ from case to case. The minimum economic rate of return reported by all WB and AsDB in Cambodia over a period 1992-2005 was 8.1 percent for a mini hydro component of the Rural Electrification and Transmission Project, WB, 2003. At the same time the highest EIRR reached 32 percent for the transmission component of the Greater Mekong Subregion Transmission Project, AsDB, 2003.

Table 3.12: Project Returns in Electricity Sector

Donor / Project	Sector(s)	Approval Date	Amount (US$ million)	Executing Agency	Status	FIRR (%)	FNPV (US$ million)	EIRR (%)	ENPV (US$ million)
[WB] Rural Electrification and Transmission Project 220kV Transmission: Border to Cambodia Rural Electrification Components: • Grid extension • Isolated systems • Mini hydro	Power / Law and justice and public administration	Dec 2003	40.0	MIME / Electricite Du Cambodie	Active	35.4% n/a	32.5% n/a	32.5% • 19.8% • 22.3% • 8.1-19.4%	200.0 @ 12% • 7.9 @ 12% • 9.6 @ 12% • 9.3 @ 12% *****
[AsDB] Power Rehabilitation Project At appraisal (1994) • Phnom Penh • Sihanoukville • Siem Reap At completion (2000) • Phnom Penh • Sihanoukville • Siem Reap At audit (2001) • Phnom Penh • Sihanoukville • Siem Reap	Power	Oct 2001	28.0	MIME / Electricite Du Cambodie	Closed	• 44.1% • 9.1% • 12.9% • 6.6% • 13.6% • 14.9% • 8.9% • 15.2% • 11.9%	n/a n/a n/a	• 37.4% • 15.6% • 19.8% • 44.3% • 24.9% • 33.2% • 18.3% • 16.1% • 15.5%	n/a n/a n/a
[AsDB] Special Rehabilitation Assistance • New diesel generators	Multisector: Transport / Agriculture / Power	Dec 2000	68.6	MOP	Closed	n/a	n/a	• 20.8%	n/a
[AsDB] Provincial Power Supply Project • Banlung (gen.) • Kampot (gen.) • Kompong Speu (tran.) • Prey Veng (gen.) • Sisophon (gen.) • Stung Treng (gen.) • Svay Rieng (tran.) • Takeo & Angtassom (gen.)	Electricity generation and distribution	Nov 2000	18.6	MIME / Electricite Du Cambodie	Active	4.2% • 4.1% • 4.1% • 4.6% • 4.6% • 3.2% • 4.3% • 5.4% • 3.9%	n/a	17.8% ****** • n/a • 19.8% • 20.3% • 14.6% • 17.1% • 12.2% • 22.0% • 14.6%	4.7 @ 12% • n/a • 1.0 @ 12% • 1.1 @ 12% • 0.2 @ 12% • 0.9 @ 12% • 0 @ 12% • 1.3 @ 12% • 0.3 @ 12%
[AsDB] Greater Mekong Subregion Transmission Project • Transmission component • Distribution component	Electricity transmission and distribution / Regional cooperation	Nov 2003	44.3	MIME / Electricite Du Cambodie	Active	• 35.3% • 12.6%	• 65.9 @ 6% • n/a	• 32% • 25%	• 201.3 @ 12% • 5.3 @ 12%

Sources: *Project reports of the World Bank and Asian Development Bank.*
Notes: * *A total net present value for several small hydro projects.*
** *The economic evaluation of benefits is conservative, as no attempt was made to evaluate the benefits of improved reliability and quality of power supply, and cost savings to many individual consumers who require standby private generating sets now to ensure reliable power.*

4. ADMINISTRATIVE REFORM

MANUFACTURED EXPORTS AS THE FOCUS OF A STRATEGY FOR GROWTH

To reduce the incidence of poverty in a country, it must raise the value of the only resource the poor have – their labor. In the last 50 years most countries that have been successful in enabling their citizens to largely escape from poverty, have done so through the creation of jobs in the sectors manufacturing for the export markets. In a study done over 20 years ago for Indonesia (Flatters and Porter, 1984), it was found that for every dollar invested in the manufacturing exports sector the result was the creation of 4 times as many jobs and 4 times as much net value added as would be created if this same amount was invested in import substitution activities. The rapid growth of job creation in Indonesia during the period 1985 to 1990 was due primarily to a compound growth rate of manufacturing exports of more than 40 percent a year over the decade. This rapid expansion of manufactured exports followed the implementation of a comprehensive set of economic reforms in 1985 that were focused on improving the country's international competitiveness.

Cambodia has made many of the policy changes necessary for the promotion of exports. The two most important ones are the elimination of exchange controls and the exemption from import duties and domestic sales taxes of all imported inputs that are being used to manufacture exports. These are two of the most important steps a country can take when launching a policy of export lead growth.

Manufactured Exports and Poverty Eradication

The country's focus on an export-oriented growth strategy has many advantages for the poor, but at the same time some very fundamental contraints. On the positive side, exports from developing countries tend to be labour intensive. As the exporting firms expand they hire workers which tends to bid up the wage rate of such skills in the economy. In these sectors the opportunities for real cost reductions (productivity increases) are enormous, and the path to obtain these rewards are known and well laid out. The first requirement is to foster a competitive environment where entrepreneurs are rewarded for introducing cost reduction measures. This usually requires a government that facilitates business development through the provision of public infrastructure and a business environment characterized by a stable institutional environment and a reasonable legal system. The track record of Singapore, Malaysia and Thailand are obvious country examples to follow.

On the side of the constraints, if higher costs are imposed through either taxation or unnecessary administrative costs then the compensation paid to labor employed by these exporting firms must fall by an equal amount if the firms are to remain competitive. This comes about simply because, Cambodia can neither change the international prices of the goods it sells, nor the prices of the imported inputs it buys. Furthermore, the rate of return on capital that is required by the international investors is something that Cambodia can only change by changing the level of risk investors see when considering investing in Cambodia. Hence, additional administration costs created by inefficient bureaucrats and unnecessarily drawn out proceedures imposed on the export sectors directly must reduce the incomes of labour employed in the sector by the same amount.

The surprising conclusion is that labour as a whole, will usually bear multiples of the burden imposed on the firms by these unnecessary administrative items that make up the "high cost economy". The labor market for the types of skills used in the export-oriented firms usually extends well beyond these firms. The women and men tend to be young, relatively inexperienced, with a basic level of education. While not poor themselves, their remittances usually goes to family members who would otherwise be classified as being poor. When wages are depressed in the exporting sector due to these additional costs, all labour of similar types are also depressed in the economy. The labour market for these kinds of skills is basically a national labour market. When the wages in the export sector are depressed then wages for similar skills in the retail services sector or in the domestic manufacturing sector are also depressed.

A recent estimation of the ultimate burden borne by labour from such additional costs imposed on export manufacturing firms was carried out for the Dominican Republic. It was found that labour in the economy suffered six times the as much as the value of these additional costs benefited the receipients.[32] For example, if administrative inefficiencies are allowed to exist, or bribes need to be paid when imports and exports are handled for these export manufacturing firms, then the workers in the economy will suffer losses of income equal to six times the cost of these inefficiencies and bribes.

It is clear that the impacts of the impediments to the expansion of manufactured exports on labor incomes and the poor families that they support are stark. If the beneficial impacts of the expansion of manufactured exports are to be realized then everything must be done to promote efficiencies in the administration of international trade and in the infrastructure that supports these these industries.

Strategies for Reducing the High Cost Economy

The strategy of countries like Taiwan and Singapore has been to do everything possible to reduce the unnecessary costs borne by firms and labour in the process of conducting international trade. While in Cambodia it can take up to a week to clear imported goods and sometimes export goods from Customs, with average time measured in days, in Taiwan and Singapore the average clearing times are measured in minutes with major delays measured in hours.[33] The introduction of the TradeNet System in Singapore gives one an idea of the magnitute of the economic benefits that can be created by investments in trade facilitation. The total cost of the informations system that linked the customs, brokers, ports and banks (TradeNet) was approximately US$ 20 million. The benefits in terms of cost savings to the

[32] Maida Hamzic, "The Evaluation of Economic Implications of the World Trade Organization Reforms on Free Trade Zones: The Case of the Dominican Republic", MS Thesis in Economics, Eastern Mediterranean University, North Cyprus, 2005.

[33] Jenkins, Glenn, *Taxation and Development in Taiwan*, (with CY Kuo and KN Sun), Harvard Studies in International Development, Harvard University Press, Cambridge MA, 2003.

country were estimated to be approximately US$ 600 million per year.[34] These cost savings ultimately end up raising the incomes of the labourers in Singapore, by multiples of this value. In 1985 in Indonesia, the government found it necessary to remove the customs functions of goods inspection completely from the customs officials and to employ an international private firm to undertake these activities. The reductions in costs to importers and exporters were dramatic. Following this policy change the volumes of manufactured exports grew on average over 40 percent a year for the next 5 years.[35]

Recently in Costa Rica the governmernt introduced a single window warehouse clearing, electronic customs declaration, and an automatic risk management system for customs. It reduced the customs clearance times from an average of six days in 1994 to 12 minutes in 2000 (WTO 2001).

In countries, like Cambodia today, where the systems creating the unnecesary costs and delays in importing and exporting are deeply rooted and politically difficult to reform, a strategy should be followed to create new systems that are designed to service the export sector and operate in parallel for a period with the existing system that is used for other types of imports. Eventually, the new system can be modified to have a more general application and hence become the universal system for the country.

FREE TRADE ZONES

In the Dominican Republic this involved the development of Free Trade Zones (FTZ), that started out as export processing zones, but have now evolved to the point were they are essentially Special Economic Zones. These zones can be as small as a factory or farm and go up to very large industrial park areas. Until now the Dominican Republic has not adequately reformed its Customs system for handling cargo in and out of the non-FTZ areas. However, the industrial free zones have essentially their own customs service, that is paid for by the FTZ operators, and their own set of taxes and documentation for import and export. In the Dominican Republic, essentially no firm or commodity taxation is levied, including VAT, import tariffs, export taxes, or corporate income taxes. Income taxes on individuals and social security is paid by all the employees working in the zones. Taxes on fuels for motor vehicles are taxed in the FTZ the same way as it is taxed outside of the zones.

The result is that goods going to and from the FTZs are processed very quickly and the administration costs are very low. To avoid a trucking oligopoly that was charging very high local transportation rates, the firms or the zone operators are allowed to pick up and deliver the goods to the ports and airports with their own vehicles.

The system in the Dominican Republic still relies on physical controls, with fences around the FTZ facilities and customs officials (zone based) accompaning the shipments to and from the ports and airports. However, the relationship between the FTZ administration and the

[34] Jenkins, Glenn "Economic Reform and Institutional Innovation," in *Bulletin for International Fiscal Documentation*, Vol. 46, No. 12, IBFD Publications BV, Amsterdam, The Netherlands, December 1992.

[35] Ibid.

Customs (government) is good and every effort is made to reduce unnecessary costs that arise in adminstration of international trade. For example, there is only one import document required by Customs for importation of goods. In addition, as electricity supplies have been a chronic problem in the Dominican Republic, many of the Zones have their own power supplies and the factories and other operators in the Zone tend to purchase the electricity from the Zone operators. In this way some economies of scale are realized in the electricity generation area, and increased reliability can be achieved at a lower cost due to the sharing of reserve capacity.

In 2005 the Dominican Republic has entered into the Central American Free Trade Area (which includes the USA). As a consequence it must reform its trade administration and taxation system to make it fully compatible with the WTO, and to have an efficient trade administration both outside as well as inside the FTZs

Export Processing Zones

Taiwan initally set up export processing zones as a way to reduce the administrative costs facing exporters. At that time in the 1950s the firms producing manufactured exports in Taiwan was facing many of the problems with its Customs, ports and tax administrations that the garment producers are facing in Cambodia today. The initial solution in Taiwan was to set up export processing zones that basically bypassed all the existing bureaucratic systems by using their own new systems for the administration of imports and exports for the zones. Realizing that export processing zones were a relatively expensive to operate, and not as flexible as was desirable for the Taiwanese manufacturing exporters, they developed an accounts-based duty and taxes suspension system to track the imports and exports of each firms. This system allowed exporters who were importing inputs to use in manufacturing to buy their goods duty free and free of the domestic sales taxes. Customs simply kept a record of the amounts of materials imported and the amounts that were exported in the goods being shipped abroad. This “duties and taxes suspension” system proved to be cost effective and as a result it caused the export processing zones to become largely obsolete. In no year from 1955 to present did the exports from the export processing zones reach more than 9 percent total annual exports from Taiwan.

Special Economic Zones for Cambodia

The proposal to develop one or more special economic zones in Cambodia that are dedicated to firms engaged in manufactured exports is an idea that is worthy of support.There are a number of issues, however, that need to be considered carefully in the design of rules governing these facilities. In general the proposals below are designed to allow in the future an easy integration of the SEZs into the rest of the economy.

1. The present exemption from import tariffs, VAT and other indirect taxes of all imported goods to be used in the manufacture of exports should be continued for all operations in the special economic zones.

2. The One-Stop-Shop system should be implemented to reduce the need for the exporters to have to deal with a large number of government officials in order to process the paper work. There should be a single agency, located close to the factories in the zone that can deal with all the adminstrative worked associated with the imports, and export functions of the factories. This will eliminate the need for every garment factory to have to maintain an office in Phnom Penh simply to handle the administrative functions for the factory involving the Government Ministries and organizations.

3. An accounts-based suspension system should be used to administer this duty and tax suspension system. We would recomment that no bank guarantee or bond be required for exporters who have a track record of performance (two or three shipments). Such guarantees are usually necessary to drive away people who have not track record and are simply importing on an ad-hoc basis for the domestic dconsumption. Once it is clear that the firm is an exporter the risk of faud through the diversion of the imports to the domestic market is very low.

4. The firms in the special economic zones should be allowed to make sales into the domestic economy if they pay all the import duties that would otherwise have been paid on their inputs if they had been operating in the rest of the domestic economy.

5. The firms operating in the SEZ should be allowed to sell into the domestic economy but should be subject to the full rate of VAT on the sales price of the items. No VAT input tax credits should be allowed as a deduction from the amount of VAT owed on sales into the domestic economy. Any purchases made by the firms in the SEZs from suppliers located in the rest of the domestic economy should be zero rated for purposes of VAT . In terms of motor fuels the VAT should be levied at its normal rate, but it should generate no VAT credits in the hands of firms operating in the SEZ.

Implications for Government Expenditures

At the present time a number of initiatives are being studied, and implemented, to lower the compliance costs of the international trade management system. These changes will all require public sector expenditures to be made to implement them and under most circumstances to operate them in the future. There will also be considerable resistence to these changes because of the special interests who are now benefiting from the current high cost systems will lose from the implementation of these reforms.

Given the experience of countries mentioned above, there is likely to be no other government exenditure would have as high a rate of return at the present time as would investments in the technology, institutions and infrastructure needed to create an efficient international trade management system for Cambodia. The reduction in compliance costs immediately brings about higher returns to the private sector investments. Throught the expansion of the private sector as a response to the higher rates of return there will be a better utilization and higher economic returns arising from the public sector infrastructure that is used by to the private sector activities.

PUBLIC SECTOR INVESTMENT PREPARATION UNIT

At the present time Government of Cambodia lacks the institutional capacity to identify, appraise and prepare for funding a portfolio of potentially high return projects in the public sector. Perhaps in the past it was necessary for many of the development projects to be essentially donor driven. Looking to the future this approach is unlikely to be a viable option for the economic development of the country. It is proposed that the country start immediately to build up the skills within the public sector in the area of public sector investment appraisal. This is an effort of building human capital within the country that will have a large payoff for both the public sector as well as for the private sector. It is the private sector who is the ultimate beneficiaries of the high economic return infrastructure and social investments that such a professional process of capital expenditure selection and implementation helps to realize.

In the late 1970s and early 1980s a similar problem was faced in Sri Lanka. With the country's movement away from a collapsed socialist system, there were very few projects prepared and ready for donor financing. The only significant project that had been identified many years before was the Mahaveli river irrigation scheme that comprised a series of large dams and water distribution networks. To get the economy growing the donors agreed to finance this scheme. It was planned in a rush, experienced spectacular cost overruns, and has yielded marginal returns to the farmers and households it was supposed to assist.

At about the same time a number of the donors, under the leadership of the World Bank, set up a project preparation unit in the Ministry of Finance and Planning. The task of this group of people was to identify and appraise a wide range of projects in the agriculture, irrigation, and transportation sectors, and prepare them for donor financing. Within one year they had identified, appraised and prepared for financing an impressive portfolio of high return projects. Unfortunately, the cost overruns of the Mahaveli scheme began to crowd out the ability of the donors to finance these smaller projects that promised much greater returns than the Mahaveli scheme. As a result many of these projects were delayed for 5 to 10 years. The absence of such an institution to identify, appraise and prepare projects for financing at the beginning of the economic reform process cost Sri Lanka a substantial amount of real growth in the years to follow.

In the early 1970s Malaysia adopted a New Economic Policy that aimed to bring about a major transformation of the economy. This policy has been largely successful at eradicating poverty from the vast majority of the population. A key institution in this process was the Economic Planning Unit (EPU) in the Prime Minister's Department. Its role was to assist the various departments in appraising their various proposals for investment and in assisting the departments in obtaining the financing for their investment proposals. The EPU coordinated all development assistance coming into the country.

From its involvement in the appraisal of numerous project proposals, and in monitoring the actual performance of implemented projects, the EPU was able to develop broad guidelines on what kinds of public sector investments should be undertaken in the infrastructure sectors in such areas as irrigation, roads, health, education, and set out the priorities for implementation. The EPU left it to the various departments to manage the implementation of the projects, and also in initial identification of the investment projects. However, it monitored the progress of all the major projects in their implementation. In addition, it served as a resource that worked with the departments to screen out the low return projects from the ones that appeared promising.

The Economic Planning Unit of Malaysia still functions until today in much the same manner. However, today it plays a much more important role in setting out the central strategic policies governing the development of the country. Since 1993 many of the public services in the economy are being supplied by private operators under contract or concession with the government. It sets out the basic guidelines for the assessment on the various investment or supply options and in the design of the appropriate regulatory framework under which these activities should operate. Throughout the history of this institution, it has been generally recognized both domestically and internationally that the EPU has fulfilled an essential role in selection and implementation of public sector capital expenditures. (www.epu.jpm.my)

These are two examples of the importance of developing the capacity within the government of professionally evaluating the options it faces in the area of capital expenditures. By the nature of the public sector, many investment projects benefit a relatively small number of people while the costs of the project are either borne by donors or spread over a large number of taxpayers in the county. In this situation, it is professionals in the civil servants that have to bring together the comparison of the size of the benefits with the amount of the costs. If public sector investment decision-making is simply demand driven by the political process of the country, then it is likely that several low return projects where a small number of beneficiaries, each benefiting a substantial amount, will get selected, but to the detriment of the rest of society.

This problem was recognized in the 1970s in Chile. They set up a public sector investment appraisal system where each department was asked to carry out an appraisal of their projects following guidelines set out by the Ministry of Planning. At the same time they set up a training program at the Catholic University of Chile that trained 25 people each year in a Master's level graduate program in public sector investment appraisal. As part of their program these students evaluate a set of major government capital expenditures that are currently under consideration by the government. This program continues in operation until today. From an initial base of about zero, by now over 500 public servants are professionally trained to carry out a professional evaluation of public sector capital expenditures. Chile has for the past 20 years been the fastest growing country in Latin America. It has transformed itself from being a country relying on import substitution industrial policies with high rates of inflation, to being the most stable; export oriented, and developed country of the region. The professional input in the selection of the government's capital expenditures has played an important role in this process of transformation.

The Province of Limpopo in South Africa is one of the two poorest provinces of the country. In 2000 they developed a strategic plan for the development of the Province that was oriented towards the facilitation of the private sector to bring about growth in the sectors of the economy which had a strong potential for development. However, due to the long liberation struggle that was fought in this part of the country, the poor state of the infrastructure was a real constraint for such a development process to occur. With substantial sums of money coming from the National Government, and the very low skill levels of the public officials in the Provincial Government, the concern of the leadership in the Province of Limpopo was whether these funds would be invested in correct manner. The fear was that they would get wasted through a politically demand driven allocation process.

In this case the Department of Finance and Economic Development took the lead to build the capacity within the government departments in this area. Over a period of 5 years over 25 people were sent to an intensive 5 week program at a university abroad. These people were from the key positions in each department who were responsible for the selection and appraisal of their capital projects. In addition, a further 50 people were given the same course in Polokwane, the capital of the Province. In addition, 30 officials where given a two week intensive course in Project Management. To accompany this training an investment appraisal manual was prepared to guide the government officers in the appraisal of such investments. Further, for those departments where the bulk of the capital expenditures are taking place, sector specific handbooks (roads, school building, hospital and clinic projects) were prepared with detailed guidance on how such projects should be appraised and how should the projects be prioritized. In these sectors the backlog of good projects that are needed to be implemented is several years long, yet without proper criteria for project selection it was found that approximately 25 percent of all the capital expenditure being made was being wasted.

Already this training has had a substantial return, through a much better set of investment expenditures in bulk water supply in the Province, a better system of setting priorities for selection of school building construction, hospital construction and road building.

We would recommend that the Government of Cambodia should consider such a program of practical skill development in the areas of public sector investment appraisal and project management. Given the country's and the government's its low base of such skills at the present time, it a situation very similar to that of the Province of Limpopo in South Africa. Unless that investment is made in the human capital of the government officials so that they can properly evaluate and promote the investment that are highly productive with in the government decision making process these key capital expenditures will continue to me made on an ad hoc fashion.

The skills that the public sector official obtains for the appraisal of investment are skills can be used to assist in many other areas. For example, the same skills are used in the evaluation of the cost and benefits of regulations, or the costs and benefits of actions to promote compliance with tax laws, environment laws, or safety regulations. Many of the resource allocation issues and benefit measuring techniques are identical. Finally, these skills are also badly needed, and heavily used in modern investment decision making by the private sector. Even though the public sector officials that are given this training eventually leave the government and move to the private sector the resources spent on this area of skills development are not lost to the country. They will assist the private entrepreneur to make better and more efficient private investment decisions which is ultimately the primary source of growth for a country.

Recommendations

1. A small number (4 or 5) government officials who hold either managerial positions or positions requiring a high degree of profession competence should be sent abroad for 6 weeks of intensive training in conducting integrated investment appraisals. This should be done for perhaps two years in a row.

2. A series of modular courses be taught in Cambodia for 20 to 25 participants that cover the same curriculum but in a series of one or two week courses. These courses could be taught in the local language or in English, depending on the audience.

3. As part of these courses, each of the participants would be expected to complete an appraisal of an actual public sector project.

4. A unit should be set up within the government where some of the graduates of this training would be asked to work with officials from the line department to evaluate major investment initiatives.

4. If permission is obtained a series of course materials should be prepared that utilizes these cases as training materials in future courses.

5. These local courses should be planned to be delivered each year for a period of about 3 years. During this time trainers from a local university or a research organization would be trained and given an opportunity to gain experience both teaching as well as working with the officials in the preparation of the feasibility studies for government projects.

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Annex A: Sector Definition, Based on IFAPER 2003, World Bank

Core Government

General Administration:

01	Royal Palace,
02	National Assembly,
03	Senat,
04	Constitutional Council,
05	Council of Minister: 5.1 Prime Minister Office & 5.2 Secretariat of Public Service & 5. 4 Council for Development of Cambodia,
07	Ministry of Interior: 7.2 General Administation & 7.9 Provinces,
08	Ministry of Relations with the National Assembly, Senat and Inspection,
09	Ministry of Foreign Affairs and International Cooperation,
10	Ministry of Economy and Finance,
11	Ministry of Information,
14	Ministry of Planning,
28	Ministry of Territorial Organization, Urbanization and Construction,
30	National Economic Council,
31	National Audit Authority,
99	Reserve Funds: Provincial Subsidies.

Defense:

06	Ministry of National Defense.

Security:

07	Ministry of Interior: 7.1 Public Security.

Judiciary:

26	Ministry of Justice.

Economic Services

Agriculture:

17	Ministry of Agriculture Forestry and Fishery,
29	Ministry of Water Resources and Meteorology.

Transport:

Public Works	25 Ministry of Public Works and Transport.
Other Transport	5 3 Council of Minister: Civil Aviation.

Other Economic Services:

13	Ministry of Industry, Mine, and Energy,
15	Ministry of Commerce,
22	Ministry of Posts and Telecommunications,
27	Ministry of Tourism.

Environmental Protection:

19	Ministry of Environment.

Rural Development

20	Ministry of Rural Development.

Social Services

Health:

12 Ministry of Health.

Recreation, Culture & Religion:

16 Ministry of Education Youth and Sports: 5.3Youth and Sport,

23 Ministry of Religious and Cults.

Education:

16 Ministry of Education Youth and Sports: 16.1 Education & 16.2 High Education & 16.9 Provinces.

Social Protection:

21 Ministry of Social Affairs, Labor, Vocational Training and Youth Rehabilitation,

24 Ministry of Women Affairs and Veteran.

Other

Debt:

99 Reserve Funds: Total Debt.

Capital Expenditure:

99 Reserve Funds: Ch. 50.3: Investment by foreign funds.

Other not classified:

99 Reserve Funds: Ch. 40: Miscellaneous & Ch. 41: Contingencies.

Annex B: Treasury-Executed Spending by Function, 1996-2005 (US$ millions, constant 2005 prices)

Function	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005B
Core Government	**180.8**	**181.8**	**205.8**	**200.2**	**255.8**	**240.7**	**273.9**	**271.6**	**247.0**	**228.9**
General Administration	49.1	45.2	77.2	69.4	126.1	121.1	130.5	155.4	132.3	115.0
Defense	93.9	94.0	87.4	92.4	87.6	77.8	72.4	73.4	70.2	71.0
Security	36.9	41.9	40.7	37.1	40.4	40.0	39.0	39.7	41.8	39.7
Judiciary	0.8	0.8	0.6	1.3	1.7	1.8	32.0	3.0	2.7	3.2
Economic Services	**31.3**	**40.5**	**27.5**	**51.9**	**54.5**	**79.6**	**94.0**	**81.8**	**67.6**	**81.0**
Agriculture	6.0	7.4	5.1	6.9	10.1	18.6	19.5	21.5	17.6	25.7
Transport	8.9	11.8	5.2	9.5	22.3	30.3	42.3	31.3	29.8	29.6
Public Works	7.5	7.4	3.7	8.1	20.6	25.4	40.9	29.3	28.2	26.9
Other Transport	1.3	4.3	1.5	1.4	1.7	4.9	1.4	1.9	1.6	2.7
Other Economic Services	15.7	20.9	16.8	34.9	21.0	28.6	29.9	26.7	17.9	23.0
Environmental Protection	0.7	0.5	0.4	0.6	1.1	2.1	2.2	2.4	2.3	2.6
Rural Development	**1.6**	**1.1**	**1.7**	**4.3**	**3.5**	**8.4**	**17.5**	**22.6**	**20.9**	**17.0**
Social Services	**56.1**	**61.0**	**55.8**	**96.7**	**107.9**	**132.8**	**158.5**	**169.2**	**175.3**	**179.1**
Health	13.9	16.9	12.4	34.6	29.0	37.1	46.4	48.1	50.6	59.7
Recreation, Culture & Religion	1.7	2.2	1.9	2.8	7.9	9.1	8.5	9.1	6.9	8.3
Education	26.1	26.0	28.0	41.9	46.3	61.1	76.8	80.2	84.2	85.6
Social Protection	14.4	15.9	13.6	17.4	24.6	25.5	26.7	31.8	33.6	25.5
Other	**18.8**	**2.9**	**5.6**	**12.9**	**12.5**	**10.5**	**44.1**	**87.0**	**42.9**	**118.0**
Debt	18.8	2.9	5.6	9.0	8.8	8.3	10.0	40.8	21.9	34.2
Capital Expenditure	-	-	-	-	-	-	28.8	36.6	18.1	48.2
Other not classified	-	-	-	3.9	3.7	2.2	5.3	9.6	2.8	35.6
Total	**288.6**	**287.4**	**296.4**	**366.1**	**434.1**	**472.1**	**588.0**	**632.2**	**553.7**	**624.0**
Priority Sectors	**47.6**	**51.5**	**47.2**	**87.7**	**89.0**	**125.2**	**160.3**	**172.4**	**173.4**	**188.1**
Defense and Security	**130.8**	**135.8**	**128.0**	**129.5**	**128.0**	**117.8**	**111.4**	**113.1**	**112.0**	**110.7**

Source: Based on World Bank estimates and MEF TOFE.

Annex C: Sector Definition, Development Cooperation Report, Council for the Development of Cambodia/Cambodian Rehabilitation and Development Board

Whereas projects' areas of focus relate to development objectives, sectoral classifications organize projects according to their spheres of societal endeavor. A project's sector will normally be the sector its implementing agency works in.

1. Economic Management, includes:
    - Macro-economic policy and planning
    - Fiscal policy and planning
    - Monetary policy and planning
    - Employment/livelihood policy and planning
2. Development administration, includes:
    - Public administration and management
    - Foreign aid coordination and planning (includes round tables, consultative group meetings and country programme review missions)
    - Debt management
    - Technology policy and planning
    - General statistics (including demography)
    - General cartography
    - Foreign affairs and international law (excluding trade law)
3. Natural resources, includes:
    - Sector policy and planning
    - Land use planning
    - Water resources planning
    - Environmental preservation and rehabilitation
    - Mineral resources exploration and exploitation
    - Coal, petroleum exploration and exploitation
    - Wildlife and national parks
    - Sea-bed resources
4. Education (HRD), includes:
    - Sector policy and planning (includes manpower planning)
    - Pre and primary schooling
    - Secondary schooling
    - Tertiary education
    - Technical and managerial education and training
    - Non-formal education (includes literacy and adult basic education)
5. Agriculture, forestry and fisheries, includes:
    - Sector policy and planning
    - Research and development
    - Support services (includes credit, extension, input supply, crop protection, agro-meteorology)
    - Food crops
    - Industrial crops
    - Livestock
    - Forestry
    - Fisheries (includes oceanography as it relates to fishing)
6. Area development, includes:
    - Integrated rural development
    - Village/community development (includes rural and urban cooperatives)
    - Settlements
    - Intercountry area development
    - River basin development
    - Regional planning and development

7. Industry, includes:
   - Sector policy and planning
   - Technological research and development
   - Support services (includes industrial estates and duty-free zones (only if industry-wide, otherwise under specific kinds of industry))
   - Cottage and small-scale industry
   - Medium-scale industry
   - Large-scale industry
8. Energy, includes:
   - Sector policy and planning
   - New and renewable sources of energy (includes fuelwood, methane, synthetic, solar, biomass, wind, wave, etc.)
   - Hydroelectric power generation and transmission
   - Geothermal power generation and transmission
   - Conventional energy sources, generation and transmission (includes coal, petroleum, etc.)
   - Energy conservation (includes improved stoves)
9. International trade in goods and services, includes:
   - Sector policy and planning
   - Global trade policies and procedures (including GATT, GSP etc.)
   - International trade in primary goods (food, raw materials, etc.)
   - International trade in secondary goods
   - International trade in services (e.g., banking, insurance, etc.)
   - Export promotion
10. Domestic trade in goods and services, includes:
   - Sector policy and planning
   - Domestic marketing
   - Domestic trade
   - Tourism
   - Other service industries
   - Patents
11. Transport, includes:
   - Sector policy and planning
   - Road transport
   - Rail transport
   - Water transport and shipping
   - Air transport
12. Communications, includes:
   - Sector policy and planning
   - Postal services
   - Telecommunications
   - Television, radio and print media
   - Development support communication
13. Social development, includes;
   - Social legislation and administration (includes social security, occupational health and safety, legislation on women, etc.)
   - Urban development (includes sites and services, urban planning, etc.)
   - Drinking water and sanitation
   - Housing
   - Culture (includes preservation, copyrights, general libraries)
   - Prevention of crime and drug abuse

14. Health, includes:
    - Sector policy and planning
    - Primary health care (includes maternal and child health, nutrition)
    - Immunization and other disease control campaigns
    - Family planning
    - Hospitals and clinics
15. Disaster preparedness, includes:
    - Meteorology (as it relates to weather warning systems)
    - Seismic predictions
    - Early warning/food information systems
    - Relief planning and institutional preparedness
    - Physical measures
16. Humanitarian aid and relief, includes:
    - Refugees and returnees
    - Emergency relief (food, planning and logistics, medical supplies)

Annex D: Gross Domestic Product (GDP) Economic Activity at Constant 2000 Prices (Billion Riels)

	1993	1994	1995	1996	1997	1998	1999	2000	2001r/	2002r/	2003r/	2004r/	2005p/
Agriculture, Fisheries & Forestry	**3,874**	**4,259**	**4,408**	**4,459**	**4,704**	**4,942**	**5,124**	**5,065**	**5,294**	**5,180**	**5,809**	**5,880**	**6,854**
Crops	1,594	1,637	1,821	1,879	1,853	2,003	2,313	2,328	2,379	2,275	2,830	2,878	3,684
Livestock & Poultry	759	737	784	794	792	843	833	757	847	843	898	939	993
Fisheries	1,158	1,205	1,305	1,365	1,442	1,477	1,443	1,516	1,605	1,615	1,642	1,614	1,705
Forestry & Logging	362	679	499	422	616	619	535	464	462	447	439	448	473
Industry	**1,101**	**1,257**	**1,495**	**1,561**	**1,823**	**1,936**	**2,346**	**3,078**	**3,430**	**4,025**	**4,512**	**5,252**	**5,888**
Mining	18	23	28	24	23	20	27	34	37	47	55	69	86
Manufacturing	683	745	875	984	1,255	1,445	1,731	2,255	2,613	2,994	3,359	3,949	4,333
Food, Beverages & Tobacco	359	341	409	410	421	446	468	449	470	466	488	484	522
Beverage	-	-	-	-	-	-	-	-	-	-	-	-	-
Tobacco	-	-	-	-	-	-	-	-	-	-	-	-	-
Textile,Wearing Apparel & Footwear	63	79	130	205	399	548	771	1,297	1,666	2,021	2,360	2,947	3,250
Wood, Paper & Publishing	68	125	113	123	177	154	147	132	93	94	80	84	90
Rubber Manufacturing	23	22	25	30	31	55	63	69	70	69	62	55	50
Other Manufacturing	171	178	198	217	227	243	282	307	315	343	368	379	421
Non-Metallic Manufacturing	35	41	49	44	45	42	52	62	63	73	77	79	92
Basic Metal And Metal Products	14	16	19	18	18	16	18	24	25	33	38	40	41
Other Manufacturing	122	122	130	155	164	185	212	220	227	237	253	260	288
Electricity, Gas & Water	26	28	35	42	47	51	54	58	61	71	83	86	90
Construction	374	462	558	511	498	420	535	732	718	913	1,014	1,148	1,379
Services	**3,262**	**3,282**	**3,554**	**3,880**	**3,995**	**4,193**	**4,804**	**5,231**	**5,687**	**6,045**	**6,310**	**7,050**	**7,906**
Trade	1,233	1,167	1,232	1,294	1,366	1,377	1,447	1,512	1,544	1,565	1,596	1,685	1,826
Hotel & Restaurants	202	242	333	343	364	352	438	521	639	759	632	779	915
Transport & Communications	538	596	636	707	666	682	877	930	996	1,078	1,092	1,174	1,328
Finance	28	34	88	97	107	100	128	175	148	164	177	213	254
Public Administration	168	287	269	333	347	384	380	377	353	357	343	321	340
Real Estate & Business	717	552	574	617	663	735	797	855	961	975	1,192	1,343	1,436
Other services	377	405	423	489	482	563	738	861	1,047	1,147	1,278	1,535	1,806
Taxes on Products less Subsidies	**277**	**500**	**509**	**582**	**613**	**598**	**833**	**870**	**892**	**1,004**	**1,022**	**1,241**	**1,383**
Less: Subsidies	85	2	5	11	20	8	15	11	31	31	49	58	58
Less: FISIM	18	22	84	71	135	124	113	155	135	146	160	189	219
GROSS DOMESTIC PRODUCT (GDP)	**8,496**	**9,277**	**9,883**	**10,411**	**10,999**	**11,545**	**12,994**	**14,089**	**15,169**	**16,108**	**17,493**	**19,234**	**21,812**

Source: National Accounts of Cambodia, National Institute of Statistics (NIS); and IMF Country Report: Cambodia (2005).