

Department for International Development

DFID, the Department for International Development: leading the British government's fight against world poverty.

One in five people in the world today, over 1 billion people, live in poverty on less than one dollar a day. In an increasingly interdependent world, many problems – like conflict, crime, pollution and diseases such as HIV and AIDS – are caused or made worse by poverty.

DFID supports long-term programmes to help tackle the underlying causes of poverty. DFID also responds to emergencies, both natural and man-made.

DFID's work forms part of a global promise to

- halve the number of people living in extreme poverty and hunger
- ensure that all children receive primary education
- promote sexual equality and give women a stronger voice
- reduce child death rates
- improve the health of mothers
- combat HIV and AIDS, malaria and other diseases
- make sure the environment is protected
- build a global partnership for those working in development.

Together, these form the United Nations' eight 'Millennium Development Goals', with a 2015 deadline. Each of these Goals has its own, measurable, targets.

DFID works in partnership with governments, civil society, the private sector and others. It also works with multilateral institutions, including the World Bank, United Nations agencies and the European Commission.

DFID works directly in over 150 countries worldwide, with a budget of some £4.6 billion in 2005. Its headquarters are in London and East Kilbride, near Glasgow.

WHAT ARE COUNTRY ASSISTANCE PLANS?

Country Assistance Plans set out how we aim to contribute to the achievement of the Millennium Development Goals in various countries. Country Assistance Plans start from the basis of our partner country's poverty reduction strategy and set out in detail how we will work as part of the international development effort to support a country's strategy for reducing poverty. They include a framework for annual assessment of DFID's performance in implementing the plan. Major reviews of Country Assistance Plans leading to new printed documents are expected to be undertaken every three to four years.

Preface

The Asian Development Bank (ADB), DFID, the United Nations system and the World Bank worked together to prepare their new Cambodia country plans/strategies. The country strategies are built upon the priorities and analysis embedded in Cambodia's National Poverty Reduction Strategy and the Government's Rectangular Strategy, and build on strengths and experience of the individual partners in Cambodia. The strategies were developed in close and on-going consultation with Government, donors, civil society and the private sector.

By working together, the partners hope to generate greater synergy through a shared understanding of the development priorities and articulation of a consistent set of messages. This collaboration aimed also to increase coordination in policy dialogue and reduce the Government's transaction costs in dealing with donors. The four partners held joint consultations with stakeholders during this process.

Country Assistance Plan for Cambodia

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Part 3 and Annexes 1 and 4 are to be made available electronically on the DFID website, www.dfid.gov.uk. This is subject to change from time to time. Enquiries can be sent by email to 'enquiry@dfid.gov.uk'. Alternatively, hard copies of Part 3 can be sent on request. Please phone 0845 3004100 or write to Enquiry Point, DFID, Abercrombie house, Eaglesham Road, East Kilbride, Glasgow G75 8EA.

Parts of the text are common to the strategies of the Asian Development Bank, DFID, the United Nations and the World Bank. They are paragraphs 2.1 – 2.20; 2.22 – 2.38; 3.2 – 3.11; 4.1, parts A-F.

Summary

- 1.1 Cambodia is among the poorest countries in the world with 34% of its people living on less than \$1 a day. After three decades of constant conflict that only ended in 1991, Cambodia is steadily building its shattered infrastructure, society and economy and huge challenges remain for its Government and people. HIV and AIDS remains a major threat although HIV and AIDS adult prevalence rates have fallen by one-third to 2.6% in 2002. The Government has set out ambitious plans for accelerating and diversifying growth, reaching poor people and providing vital basic services, but implementation of these plans is proceeding too slowly. Improving governance, reducing corruption, strengthening the rule of law and increasing the accountability of the Government to its people are the central challenges to enabling the Government to achieve its development plans.
- 1.2 Donors in Cambodia have made significant progress with harmonisation over the past year. But much more could be achieved with the resources available for development in Cambodia and DFID will champion mechanisms to increase the effectiveness of donor assistance, and encourage greater alignment of international assistance with government strategies. We will support the Government to lead and take ownership of development processes and support sector-wide working in the sectors we work in.
- 1.3 We are also determined to find ways to reduce the transaction costs on Government from having lots of separate donors in Cambodia. We will take opportunities to merge our human and financial resources and functions with donor partners to provide better support to Government. By 2011, we expect to be able to work entirely through multilateral donors or joint donor offices and will be able to provide support to Cambodia without a separate bilateral programme.
- 1.4 DFID's financial assistance to Cambodia is expected to rise slightly from £11 million in 2005/06, to £15 million in 2007/08. We will monitor progress in delivering this Country Assistance Plan every six months with our strategy partners, the Asian Development Bank, United Nations system and the World Bank.

Part 1 – Context

A. Country situation

Current development trends and issues

Development context

- 2.1 Cambodia is at a critical juncture in its development as it moves away from a post-conflict situation and towards a more normal development paradigm. Three decades of isolation and conflict that ended only in 1991 with the signing of the Paris Peace Agreements devastated much of the country's physical, social and human capital, forcing the nation to start from scratch in rebuilding its infrastructure and institutions.
- 2.2 Much has been achieved in recent years. Cambodia has made important progress in ensuring peace and security, rebuilding institutions, establishing a stable macroeconomic environment, and a liberal investment regime. Notwithstanding these achievements, the development agenda remains daunting. Poverty rates remain very high – with around 35%-40% of the population remaining below the poverty line, and 15%-20% in extreme poverty – and inequality appears to be increasing. Recent economic growth has been narrowly based, and has not led to a significant reduction in poverty.
- 2.3 Prospects for Cambodia are, however, good. With peace and macroeconomic stability now more firmly entrenched, the country has the opportunity to make far reaching economic reforms to achieve sustained socio-economic development. Within this context, it augurs well that the government has developed a comprehensive reform agenda as set out in the Second Socio-Economic Development Plan, (SEDP2) 2001-2005, and the National Poverty Reduction Strategy (NPRS) 2003-2005, and the Rectangular Strategy to meet the Cambodia Millennium Development Goals (CMDGs).

Economic growth

- 2.4 Reflecting prudent macroeconomic policies and favourable external developments as indicated by significant aid inflows and the signing in 1996 of a bilateral trade agreement with the US, Cambodia's gross domestic product (GDP) grew by an average 6.8% from 1999 to 2002, compared to 5.6% from 1995 to 1998.

Having peaked at 10.8% in 1999, GDP growth has, however, been on a declining trend, and is estimated to have increased by 5.2% in 2003. Growth in 2003 was held back by the SARS outbreak and anti-Thai riots, which adversely affected tourism. The fact that it took one year to form a new government after elections in July 2003 also dampened the business environment. On the positive side, agriculture production staged a strong recovery from a drought-induced decline in 2002, and the export-oriented garment industry expanded strongly. Over the past decade, the industrial sector was the main engine of growth, with industry's share of GDP increasing from 13% in 1992 to 28% in 2002, and that of agriculture falling from 48% to 36% during this period. The manufacturing sub-sector was the largest contributor to incremental GDP, with garments being the key driver of such growth. Tourism also contributed significantly to growth, while agriculture has grown modestly, lagging behind population growth. Fears of a sharp slowdown in growth in 2005 with the phasing out of the Multi-Fibre Arrangement (MFA) at the end of 2004 have not been realised.

- 2.5 With Cambodia's economy remaining highly dollarized, the authorities have had limited scope to employ traditional tools for monetary management. As a result, prudent fiscal policy has been the key to ensuring price stability, and Cambodia has achieved rates of inflation well below 4% since 1999. However, with demand for riel continuing to increase with economic growth, the authorities have of late also been intervening in foreign exchange markets to stabilize the exchange rate. As a result, the exchange rate remained broadly stable at around 4,000 riels per US dollar in 2003, with inflation averaging only 1.2%. However, the government's revenue performance in 2003 deteriorated due to a drop in trade and excise taxes despite recent efforts at improving tax administration and collection. The fall in revenues widened the overall fiscal deficit to 7% of GDP in 2003 from 6.7% in 2002, and reduced spending in the priority sectors of health, education, rural development and agriculture. As in recent years, large aid inflows helped finance the deficit. Despite a modest decrease in the trade deficit, the current account deficit (excluding official transfers) widened to 10.2% of GDP in 2003 from 9.0% in 2002, owing to a narrower

services surplus as receipts from tourism moderated. The deficit was financed through private and official transfers and capital inflows, including about \$77 million in Foreign Direct Investment (FDI). Gross foreign exchange reserves at \$737 million at the end of 2003 were sufficient to cover over three months of imports. The total debt stock at the end of 2003 was estimated at 70.8% of GDP. Cambodia's debt to the United States and the Russian Federation is being negotiated and is not being serviced. As a result, the debt service ratio (relative to exports of goods and services) at the end of 2003 was only 2.9%. However, relative to government revenue, the debt service ratio increases to 5%, placing Cambodia in the category of debt stressed countries.

- 2.6 Cambodia must resolve several structural constraints to economic growth. The existing sources of growth are narrowly based on garments and tourism. Prospects for garments are however, uncertain with the phasing out of the Multi-Fibre Agreement (MFA). While 90% of the poor live in rural areas, agricultural production remains far below potential due to low productivity and constrained access to arable land and markets. New sources of growth must be tapped to achieve the 6%-7% GDP growth target in the Rectangular Strategy (RS). This would require significantly higher rates of productivity and investment. However, prospects for a significant increase in public investment are limited owing to a very low government revenue base. On the other hand, private investment is hampered by infrastructure bottlenecks (particularly in power and transportation), a weak and shallow financial system, a lack of skilled labour, and weaknesses in governance ranging from an ineffectual policy and regulatory environment and poor service delivery, to bureaucratic inefficiency and endemic corruption. While gains have been made in structural reforms over the last decade – particularly those relating to trade, price and exchange rate liberalization, tax and financial sector reforms, and privatization and leasing of state enterprises – the policy and institutional setting in almost all sectors of the economy merits substantial reform. Progress has been particularly slow in legal and judicial reforms, forcing the private sector to operate under uncertain market rules. A strengthened revenue mobilization effort will also be crucial for the government to increase social

spending and improve the quality of public services. The new Government has moved quickly to address some of these issues, particularly reducing the cost and time associated with import and export procedures and company registration, and in ratifying Cambodia's World Trade Organisation (WTO) accession package. While benefits from the latter are expected to be wide ranging – with more than 40 pieces of legislation relating to commercial transactions to be adopted over the coming years – strong effort needs to be placed on proper implementation of the legislation if the benefits are to materialize.

Poverty¹

- 2.7 Despite data limitations, there is consensus on the principal characteristics of poverty in Cambodia. Around 35-40% of the population has expenditure levels below the income poverty line, with 15-20% in extreme poverty. Poverty in Cambodia is overwhelmingly rural, from a low of 10-15% in Phnom Penh to 40-45% in the rural areas, reaching 60% in some provinces in the Tonle Sap Basin. Despite relatively robust growth over the past decade, official figures indicate that the incidence of poverty has declined only modestly from 39% in 1994 to 36% in 1999. This is due to a range of factors including the narrowness of the existing sources of growth, with few if any backward linkages to the domestic economy, poor quality of and lack of access to social services, lack of access to credit, landlessness, environmental degradation, a lack of integration of the poor to the mainstream economy, and a lack of effective voice of the poor (particularly minority groups and women) in the decisions that shape their lives.
- 2.8 Progress in reducing human, or the non-income dimensions to poverty has been mixed. There has been considerable movement toward attainment of the universal primary education target, with the net primary school enrolment rate increasing from 76% in 1997 to 87% in 2001. The quality and affordability of education has also improved, but further progress is needed. There remains significant gender inequality in education, with girls currently accounting for only 39% of lower secondary school enrolment and suffering higher dropout rates. The population's health status is

¹ The most current multi-partner poverty assessment is summarized in the National Poverty Reduction Strategy (NPRS), which is the Government's poverty reduction strategy.

low, with child mortality estimated to be 115 per 1,000 live births. Data as of the mid-1990's show a high maternal mortality rate of 437 per 100,000 live births. Around 85% of deliveries take place at home and skilled personnel attend to less than half of all deliveries. There is also an unmet demand for family planning services that has led to a population growth rate of about 2.5% per year, aggravating poverty and increasing the pressure on natural resources. Although Cambodia has the highest HIV and AIDS infection rate in Asia, it has made substantial progress, with the adult prevalence rate declining from 3.7% in 1998 to 2.7% in 2001.

- 2.9 Poverty profiles suggest that income inequality has increased, especially in rural areas. Slow agricultural growth has exacerbated income inequality. Despite Government commitments, inequalities are also pervasive in the status of minority groups, hill communities, those displaced by conflict, and women. Various poverty assessments also indicate that poverty increases with household size, number of children, and is highest where the household head is engaged in agriculture. While households with women heads are not significantly poorer than others, they are often more vulnerable, having less land and labour resources and thus rely more on risky coping strategies, such as selling assets, or pulling children out of school and sending them to work. Education plays an important role in poverty. Poverty rates are similar when the household head has no schooling or primary schooling only, and are significantly lower when the household head has secondary, technical, or higher education.
- 2.10 A significant number of people are also chronically vulnerable, moving into and marginally out of poverty as external factors affect their lives. The poor also experience a high degree of food insecurity, even in provinces which enjoy a rice surplus. The ADB-sponsored participatory poverty assessment of 2001 indicated that the poor feel disempowered, with limited access to natural resources, physical infrastructure, and basic social services². Many also identified the erosion of family and community relationships as a major concern and the lack of confidence in local and provincial administration. Health shocks due to accidents and illness are repeatedly mentioned as a

leading cause of vulnerability, landlessness, and poverty. Households spend a large proportion of their income on health care and a single health shock can be financially devastating.³

- 2.11 **Progress in achieving the Cambodia Millennium Development Goals.** While Cambodia has made some progress towards achieving the CMDGs, attaining many of the targets will be difficult. Cambodia is likely to meet the CMDG target for universal primary education. However, meeting the targets for secondary education (including female secondary school enrolment) seems unlikely. There has also been some progress towards achieving health-related goals, but at current rates, the increases are probably not sufficient to meet the CMDGs. The country is, however, likely to meet its CMDG target of reducing HIV prevalence rates by 2015. However, HIV transmission patterns are shifting, with most new infections occurring among married women and their children, a difficult group to target. Continued focus is needed to ensure that the infection rate declines. Meeting the CMDG target of halving the population below the national poverty line by 2015 would require considerably faster economic growth and a more pro-poor orientation to that growth.

Political environment

- 2.12 The Paris Peace Agreements of October 1991 initiated the process of recovery and nation building in Cambodia. With UN involvement, the first multi-party elections were held in July 1993. In September 1993, a new Constitution was adopted, which established the Royal Government of Cambodia (RGC) as a multiparty liberal democracy under a constitutional monarchy. Cambodia is a signatory to the Millennium Declaration and is a party to the six main international human rights instruments.
- 2.13 Three main political parties have dominated Cambodian politics over the last decade: The Cambodian Peoples Party (CPP), the United Front for an Independent, Neutral, Peaceful, and Cooperative Cambodia (FUNCINPEC) and, more recently, the Sam Rainsy Party (SRP). Since the first mandate of the RGC, three other nation-wide elections have been organized, including the elections for the National Assembly (NA) in July 1998 and in

² "Cambodia Participatory Poverty Assessment", Asian Development Bank, 2001. The World Bank and Asian Development Bank are conducting an updated participatory poverty assessment.

³ The Health Sector Support Strategy 2002-2007 estimates that households pay on average 12% of their income for health care.

July 2003, and the first commune elections in February 2002.

- 2.14 Although the CPP dominated the elections held on 27 July 2003, it did not win the two-third majority required under the constitution to form a government on its own. A new government was formed on 15 July 2004 after protracted negotiations between the CPP and FUNCINPEC (which at one time also represented the interest of the SRP) on forming a coalition government. While Cambodia has successfully surmounted its political stalemate, the huge size of the proposed new government (necessitated to reach agreement between CCP and FUNCINPEC) will have both direct budgetary costs, and indirect costs in terms of slow decision-making, unless there are very clear divisions of labour among the various authorities. The delay in government formation meant that the NA did not meet and no legislative business was transacted for over one year. Apart from the general climate of uncertainty created by the prolonged negotiations, a number of problems have affected the activities of all development partners, including: (i) the absence of an authorized budget, which has limited the capacity to borrow from donors, as well as meet some policy measures; (ii) the inability to pass legislation required to meet tranche conditionality under program loans; and (iii) the absence of a government program to implement the NPRS.
- 2.15 The formation of a new government on 15 July 2004 nevertheless represented a major step forward in the political development of Cambodia since the Paris Peace Agreements. While government formation has taken a very long time, it has taken place through a process of dialogue, and without recourse to the violence that characterized the previous election outcomes. Democratic developments are also gaining ground in other areas. The commune elections of 2002 represent an important step in a comprehensive program of political, administrative and financial decentralization. There is also increased participation of civil society and non-governmental organisation (NGO) groups in various areas of public concern and a relatively underdeveloped media is beginning to exercise its newly won freedoms. However, civil society organizations face significant

challenges in accessing information, dialogue and in participatory processes. The Government's capacity to engage in policy dialog with civil society is growing, but participatory mechanisms have yet to be mainstreamed into public planning or monitoring processes.

Governance and institutional capacity

- 2.16 Most institutions⁴ in Cambodia were barely functioning when the Government began its first mandate in 1993. Although Cambodia has made important progress in rebuilding institutions, the country continues to operate far below its economic and social potential due to weak governance⁵. Key areas of governance requiring reforms include: corruption, the legal and judicial system, public financial management, public administration, and local governance. The government is well aware of these challenges and has proposed reforms in key policy documents including the Governance Action Plan, SEDP2, NPRS and RS. Despite much effort being devoted to policy formulation, the implementation of reforms has been slow. There is also need for enhanced participation of ordinary citizens in public-decision making.
- 2.17 **Legal and Judicial Reform.** Strengthening the justice system and the integrity of the courts is key to ensuring effective rule of law. The rule of law plays an important role in empowering the poor, providing effective guarantees to private investors and ensuring impartial dispute resolution. Although the Council of Legal and Judicial Reform have prepared a draft Action Plan for reform, the failure to enforce existing laws undermines attempts at reform. Legal reform issues also include inconsistencies in legislation, limited transparency in legislative processes, weak capacity to draft laws, and lack of participation of stakeholders. Judicial reform issues include weak governance and corruption in the judiciary, the need for reform of the Supreme Council of Magistracy, the small number of trained judges and lawyers, and the low salaries of judges and prosecutors.

⁴ Institutions are the formal and informal set of laws, systems, and procedures, organizations, rules, and codes that shape behavior.

⁵ ADB's definition of Governance is "the manner in which power is exercised in the management of a country's social and economic resources for development". At the practical level, the term governance means how state institutions operate at the central and local level and how citizens, civil society, and the private sector interact with the state.

- 2.18 **Public Financial Management.** Weaknesses in public expenditure management in Cambodia have resulted in inefficient allocation of limited public resources, reducing the development impact of public expenditure. Public expenditure at 17.4% of GDP in 2003 is low by international standards and the revenue to GDP ratio of 10.4%, with tax revenues accounting for only 7.3% of GDP, is amongst the lowest in the world. The chronic imbalance between government responsibilities and domestic revenues is an important contributor to weak governance, manifested in low public sector salaries, under-provision of and informal payments for essential services, under-funding of operations and maintenance, and the centralization of authority over the limited revenues.
- 2.19 The Government is committed to comprehensive reform of public financial management and with donor support aims to: (a) improve budget formulation by strengthening the linkage between policies and budgets, and introducing a Medium Term Expenditure Framework, and (b) improve budget execution by strengthening cash management and overhauling treasury operations. A public expenditure tracking survey is being initiated for both the education and health sectors to identify bottlenecks and leakages in public finances at the national and local levels. Beyond these important technical solutions, it is also important for the Government to strengthen accountability mechanisms.
- 2.20 **Public Administration Reform.** Given the serious problems afflicting the civil service – low pay, absence of clear hiring and promotion policies, and low skills leading to low capacity – comprehensive civil service reform is an important priority for improving service delivery. There is an urgent need to rationalize the civil service, introduce effective performance management, and to upgrade salaries of the remaining staff to a living wage. There is also a need to improve the sectoral and geographic deployment of civil servants, as well as coordination across ministries.
- 2.21 Whilst Government needs to increase its leadership of public administrative reform, donors themselves need to take a more coordinated role in supporting salary reform and performance management – current efforts are often contradictory.
- 2.22 **Corruption.** Weak institutions and limited mechanisms of accountability, which are legacies of Cambodia's recent history, contribute to high levels of corruption. Although difficult to quantify, the evidence suggests that corruption seriously constrains economic growth, private sector development, and poverty reduction. A recent study of the country's competitiveness identified the cost of corruption as the single most important constraint faced by the private sector in doing business in Cambodia⁶. Other surveys also indicate corruption to be a key concern of households, firms, public officials, NGOs and academics.⁷
- 2.23 Gaps in the legal framework and weak implementation of existing laws and regulations have hampered anti-corruption efforts. Although some progress has been made in establishing a National Audit Authority and in introducing procurement procedures in most ministries, the Anti-Corruption Law, which was endorsed by the Council of Ministers in 2003, has yet to be ratified.
- 2.24 **Decentralization.**⁸ The Government sees decentralization as crucial to the strengthening of local voice in government and improving public service delivery. While the holding of commune elections was an important first step, further effort is needed to expand opportunities for citizens to influence and participate in governance. Currently the commune councils control very limited resources resulting in low levels of implementation of services and investment. They still lack the authority, administrative capacity, and financial resources to accelerate development at their level, and have limited means for dispute resolution. Government policy on deconcentration has not yet been clearly articulated and there is a need for stronger harmonization between decentralization and deconcentration policies.

⁶ World Bank "Cambodia: Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy", 2004

⁷ World Bank Client Survey June 2003; Asia Foundation Survey 2003

⁸ *Decentralization* refers to the transfer of governmental powers, mandates and resources from central government to sub-national authorities. *Deconcentration* refers to assignment of central administration to a lower level of administration.

Gender assessment⁹

- 2.25 Cambodia has among the lowest levels of gender equity in Asia as measured by the gender development index (0.427) and the gender empowerment index (0.283)¹⁰. Social attitudes and tradition deem women to be of lower status. The consequences of these traditional attitudes are clearly manifest in the significant gender inequities in educational attainment and levels of literacy, higher rates of child labour, gender inequities in access to public services, and low representation in decision-making positions. Progress against human development indicators is also worse among Cambodian women than men across all economic groups.¹¹
- 2.26 Women make significant contributions to the national economy and the incomes and well-being of their households. Women comprise 54% of the skilled agriculture and fisheries workers and their incomes provide for more than half of household expenditures. Within the context of a shift to a market economy and private sector development, women have made significant gains in securing paid employment in recent years. These gains have, however, been limited to the garments industry whose immediate future is uncertain. The garment sector employs relatively better-educated young women and a substantial number of rural households receive regular income transfers from their daughters. Outside of agriculture and garments, women are primarily self-employed in small, informal enterprises and comprise 49% of self-employed retail traders. In addition to culturally prescribed notions of "male" and "female" occupations, the lower levels of literacy and education of women make it difficult for them to compete. Lack of access to, or control over, productive resources and services including credit, land and land titles, agricultural inputs and extension services are critical gender issues.
- 2.27 Although progress is being made in responding to gender inequities in social sectors, serious gaps remain. In education, while there is increasing gender equity at the primary school level severe disparities persist at higher levels of schooling, and the female child labour rate of 50% in the 14-17 age group is considerably

higher than the male child labour rate of 36%. In health, although progress is being made in rebuilding clinical health services, Cambodia's maternal mortality rate remains one of the highest in the region at 437 per 100,000 live births, suggesting the need for increased attention to reproductive health and improved access to health information and services.

- 2.28 Women are under-represented in both elected and appointed positions as well as in mid to high levels of the civil service. Only 8.5% of the commune councillors and 12.2% of National Assembly members are women. This under-representation of women is directly related to the low number of women candidates in party lists. Cambodia's nascent legal framework affords many rights to women yet most are unaware of such rights. General weaknesses in the judicial system together with their low social status leave women with little legal protection. As a result women are highly vulnerable to trafficking, domestic violence and rape. The legal standing of women in property disputes is also a concern. While some progress in formulating policies promoting gender equality has been achieved, mainstreaming gender continues to be a serious challenge, and the political will to implement such policies remains weak.

Private sector¹²

- 2.29 The private sector in Cambodia is dominated by the informal sector, which accounts for over 80% of GDP and close to 90% of employment. Much of informal sector activity is concentrated in agriculture. The informal industrial sector accounts for almost half of total industrial output and supplies mainly the domestic market. Some 7,000 private enterprises registered with the Ministry of Commerce constitute the formal private sector. The formal private sector has been narrowly focused on garments and tourism. Foreign direct investment has played an important role in developing the formal private sector and is the main source of exports. However since the late 1990's FDI has been on a declining trend. Constraints to private sector operations include: (i) weak governance including an underdeveloped legal framework and an ineffective

9 See *Joint Gender Assessment*, Asian Development Bank, DFID, UNIFEM, and the World Bank, 2004.

10 *Human Development Report*. United Nations Development Programme, 2003.

11 *Cambodia Human Development Report (CHDR)*. United Nations Development Programme, 2000

12 See Asian Development Bank "Private Sector Assessment and Development Strategy," 2004, and the World Bank "Cambodia: Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy", 2004..

regulatory regime, excessive red tape, and widespread corruption; (ii) a lack of access to, and the high cost of, finance; (iii) high costs and a lack of infrastructure services such as transport and energy; (iv) limited human technical and managerial skills and; (v) limited access to land, information and competitive markets.

2.30 Firm-level surveys reveal that complex registration and licensing procedures and associated formal and informal charges are a significant burden. Because of the high costs, enterprises have an incentive to remain informal to avoid these costs. Exporters complain that red tape associated with export processing cause significant delays. Registered enterprises also face an increased tax burden owing to the country's limited tax base, while smuggling from neighbouring countries negatively impacts on domestic manufacturers. Poor transport infrastructure and unofficial tolls, and the high cost of electricity due to a lack of generating capacity also increases the cost of doing business in Cambodia. Land tenure issues, due to the low level of land titling, dissuades investment in agriculture, while a lack of access to credit, especially for small and medium enterprises (SMEs) constrains private sector growth. SMEs are also constrained by a lack of a development strategy for the sector, weak entrepreneurial skill and accounting standards, and limited access to market information and technology.

2.31 The SEDP2 and NPRS reiterate the role of the private sector as the main engine of growth and poverty alleviation and commit the Government to addressing these deficiencies. Through its support for the Private Sector Forum, the Government aims to improve communication with the private sector. In joining the WTO and through efforts to enhance sub-regional trade integration, the Government recognizes the need to accelerate legal and judicial reforms, which have hitherto forced the private sector to operate under uncertain market rules. Equal effort is needed to ensuring that laws will be properly implemented. Developing a strong, independent private sector is also important to strengthening governance, as the private sector's demands for transparency and impartial arbitration can catalyze reforms.

2.32 Cambodia's accession to the WTO in October 2004 has

the potential to bring many benefits and opportunities but the Government will need to implement – and enforce – an ambitious legislative programme over the coming years for these to be realised. The greater competition and market access from membership has the potential to attract more investment, help diversify the economy and help to reduce corruption by reducing the opportunities for rent seeking. However, all of these will be dependant on putting in place a sound legal infrastructure for private sector activity, which cannot be taken for granted. Potential risks include threats to producers – particularly in the agricultural sector – from more competitive imports, exacerbated by an absence of social safety nets to ease the process of adjustment.

2.33 A more significant threat is that posed to the garment industry by the phasing out of the Multi-Fibre Agreement (MFA), which has protected Cambodia's market access against lower cost producers such as China. The garment industry has been one of the few dynamic sectors in recent years, creating employment for some 200,000 (predominantly female) workers and providing support to a much wider population of around 1 million through remittances sent back to families.

Environment

2.34 **Environmental Management.** Cambodia's economy depends heavily on agriculture, fisheries, and natural resources and its unique eco-system centered on the Tonle Sap Basin. Yet environmental management in Cambodia is weak and the legal framework for environmental management does not meet the country's needs. Information and sector guidelines are lacking on crucial aspects such as allowable forestry cut, fish yields, and groundwater resources. Poor stakeholder participation also weakens community-based management. The roles and responsibilities of the environmental agencies at various levels need to be clarified, given that up to 14 agencies are involved in the management of the Tonle Sap Basin. Management capacities are particularly weak at provincial level, forcing crucial environmental management decisions to be made at the national level. The Government's listing of key environmental challenges include: (a) decreasing

forest cover, which reduces biodiversity, increases erosion, accelerates river siltation, and worsens flooding; (b) untreated wastewater; (c) unsustainable irrigation; (d) inland fisheries and coastal resources degradation; and (e) poor protection of biodiversity and protected areas.

- 2.35 Over 20% of incomes of poor households are sourced from common resources, mainly fisheries and forestry, and serve as a "safety net" when other sources fail. Efforts to formalize community access rights to fisheries and forests are in their infancy with limited capacity to support community management. Although privately run forest concessions that were environmentally unsound or economically unviable have been cancelled, illegal logging is still prevalent. Government has also released many previously private fishing concessions in the Tonle Sap to community groups for management. While this is an important step in enhancing the access of the poor to natural resources, further strengthening of the regulatory framework and local capacity is required to ensure that communities enjoy the benefits of sustainable fisheries management.
- 2.36 **The Tonle Sap Basin (TSB) and the Greater Mekong Sub-region.** Around the Tonle Sap basin (TSB) alone some 1.7 million people depend on fishery-based livelihoods. In the dry season the Tonle Sap River drains into the Mekong and Bassac rivers near Phnom Penh, both of which flow to Viet Nam's Mekong Delta. When the Mekong rises with the monsoon rains, the Tonle Sap's flow reverses to the Northwest into the Tonle Sap Lake, raising its level by up to 10 meters and increasing its area from 3,000 square kilometres up to 16,000 square kilometres. This unique hydrological cycle generates vast areas of seasonally flooded forests imbued with intense biodiversity and one of the world's most productive fisheries. Despite the natural and ecological wealth of the TSB, it is one of the poorest regions of Cambodia. The population growth rate is rapid and social indicators low. The competing pressures on natural resources have put the entire Basin at risk of overexploitation, and the sustainable development and welfare of the entire Greater Mekong Sub-region.

Regional cooperation

- 2.37 The Government sees regional and international integration as one of the key pillars of its development agenda. It hopes it will provide Cambodia with the economies of scale and opportunities to attract investment, create employment, generate incomes and accelerate economic growth which will lead to poverty reduction. Key to Cambodia's commitment to enhance regional links has been its active role in the Greater Mekong Sub-region (GMS) and its membership in Association of Southeast Asian Nations (ASEAN). Cambodia is also pursuing other efforts to harmonize trade and investment policies in the context of ASEAN and East Asian Free Trade Areas.
- 2.38 Over the past decade, Cambodia has been fully engaged in GMS, and was the host of the first ever GMS summit in November 2002. Cambodia is an important center of the GMS strategically located between Thailand and Vietnam, and potentially benefiting from the rapid growth of both countries. Within GMS, Cambodia has entered into bilateral and multilateral partnerships to develop strategic economic corridors and cross-border initiatives, including the *Emerald Triangle* comprising Cambodia, Thailand, and the Lao PDR, and the *Development Triangle* comprising Cambodia, the Lao PDR and Viet Nam.

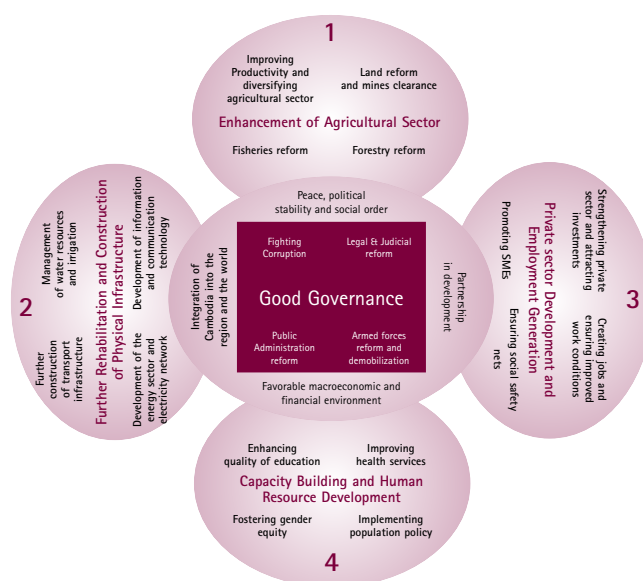
B. The Government's development strategy

Development goals and strategy

- 3.1 There have been a number of poverty plans and strategies developed over the last few years. The Royal Government of Cambodia and its development partners have repeatedly stressed the importance of now focusing on implementation of reforms. It is not yet clear the extent to which commitment and drive of the reform agenda, as laid out in the strategy documents, is owned by a broad range of government stakeholders. What is certain is that the ownership of a poverty strategy will need to be continually developed within government and the donor community will need to commit to supporting leadership of this agenda from within Government and better align their assistance with government strategies.
- 3.2 The Government's development strategy is reflected in the SEDP2¹³ and the NPRS¹⁴. SEDP2 is a comprehensive development program focusing on promoting growth, regional integration, and reducing poverty. It serves as the Government's principal planning document. NPRS is closely based on SEDP2 and elaborates the poverty reduction agenda, providing a framework for support by international development partners and a comprehensive set of monitoring indicators towards achieving the CMDGs. The Government and development partners have agreed to prepare a single planning document, the National Strategic Development Plan (NSDP), during the next planning cycle of 2006-2010.
- 3.3 SEDP2 and NPRS were formulated through a process that involved extensive analysis and consultations within Government, the National Assembly, civil society, development partners, and the private sector. The NPRS identifies eight priority poverty reduction outcomes, each with detailed actions: (i) maintaining macroeconomic stability; (ii) improving rural livelihoods; (iii) expanding job opportunities; (iv) improving capabilities; (v) strengthening institutions and improving governance; (vi) reducing vulnerability and strengthening social inclusion; (vii) promoting gender equality; (viii) priority focus on population through maternal health, increased access to education, and rural opportunities.
- 3.4 Following the formation of the new government in July 2004, the Prime Minister launched the Rectangular

Strategy for Growth, Employment, Equity and Efficiency. The Rectangular Strategy (RS), which selects key elements from the CMDGs, SEDP2, and NPRS is intended to guide the implementation of the economic policy agenda of the Government during its current term in office. The RS, which can be visualized as a series of interlocking rectangles, has good governance at its core. The other rectangles focus on the desired environment to implement the strategy, and on promoting economic growth through agriculture development, rehabilitation and construction of physical infrastructure, private sector development, and capacity building and human resource development (see diagram 1). There is understanding that this strategy needs to be translated to specific action plans and the Government has already commenced work on these.

Rectangular Strategy Diagram



Resource mobilization and investment

- 3.5 The NPRS and RS are predicated on an average annual real GDP growth rate of 6-7%. This would require a substantial increase in the volume and productivity of investment, from a projected 21% of GDP in 2004. Moreover, the actions and investments enumerated in the NPRS calls for financing in excess of \$1.5bn over 2003-2005, an amount much larger than the total of official development assistance (ODA) and domestic resources currently available to Cambodia. In the face of increased competition for concessional aid, there is

¹³ The first Socio Economic Development Plan covered 1996-2000. Prior to this, the Government prepared the *National Program for the Reconstruction and Development of Cambodia* in 1994.

¹⁴ The *National Poverty Reduction Strategy* serves as the country's Poverty Reduction Strategy Paper.

then a need to redouble efforts to mobilize domestic revenues to finance growth and poverty reduction. As indicated in the RS, this would require a significant effort to improve the collection of tax and non-tax revenues, by reducing corruption and tax evasion, dismantling the structure of tax exemptions, broadening the tax base and strengthening tax and customs administration. A complementary priority is to improve the effectiveness of spending, by linking expenditures more tightly with priority outcomes. There is also a related need to improve the investment climate and reduce the costs of doing business for the private sector.

The Role of External Assistance

3.6 Cambodia has received significantly more ODA than other low-income countries during the past decade, reflecting its post-conflict transition needs. External assistance has contributed to the implementation of all major public sector development projects in Cambodia. From 1992 to 2002, net overseas development assistance (ODA) disbursements to the country reached \$4.5 billion, with 34% from multilateral sources, 58% from bilateral sources, and 8% from NGOs. Grants account for 82% of ODA. In 2002, about \$450 million in ODA was disbursed, equivalent to almost 8% of GDP. Pledges made during the annual Consultative Group (CG) meetings have increased from \$470 million in 1999 to \$548 million in 2000 and \$635 million in 2002. On a per capita basis, Cambodia has received significantly more ODA than other low-income countries during the past decade. Aid inflows were mainly used to improve health and education, rebuild physical infrastructure, and for institutional capacity building. Given Cambodia's substantial financial needs, its limited capacity to mobilize domestic revenues, and the narrow private sector base, it will continue to rely heavily on ODA in the medium-term. However, measures to boost external resources need to be matched by improvements in the efficiency, integrity and effectiveness with which these resources are used. Lending from the International Financial Institutions and regional development bank reduced in 2004 – based on the increasing attention these organisations are giving to performance assessments on governance and Cambodia's poor performance in this area.

Harmonisation and alignment

3.7 A key priority is strengthening the capacity and effectiveness of the Government in aid management linked to the CMDGs, so as to achieve greater ownership and development impact. While aid coordination is the mandate of the Council for the Development of Cambodia, there is need to strengthen links and harmonize procedures with other key agencies concerned with ODA, such as the Ministry of Economy and Finance, and the Ministry of Planning. Given existing weaknesses, significant portions of ODA are handled off-budget and are therefore difficult to account for. There is also a need for improved donor aid coordination to enhance development effectiveness. The already high proportion of ODA dedicated to technical assistance for institutional capacity building has risen further in recent years to reach over half of all aid flows in 2003, with the bulk of this support used to buy-in external expertise. Ad hoc project-based salary supplementation schemes also remain common totalling some \$7m a year, equal/equivalent to 10% of the Government's official wage bill

3.8 A number of initiatives are, however, currently underway to promote better development partnerships. These include the restructuring of the existing Government-donor Technical Working Groups (TWGs) at the sector and thematic level, the harmonization of country strategies by ADB, DFID, UN and the World Bank and the coordination of their programs based on comparative advantage, a greater reliance on sector wide development programs, and better harmonization of donor procedures in project implementation (see section on External Funding Coordination and Partnership Arrangements). The Government has also signalled a greater commitment to country leadership of the development process, and has jointly collaborated with the ADB and World Bank in preparing a report on Standard Operating Procedures for improved implementation of donor projects. The merging of the NPRS into SEDP3 in 2006-2010 also provides an opportunity for ensuring greater development impact by increasing Government and donor harmonization and alignment around a unified development framework to achieve the MDG's.

Assessment of the Government's development strategy

- 3.9 The SEDP2 and NPRS processes introduced new approaches and themes to development planning in Cambodia, including: (a) open and extensive participation of stakeholders; (b) engagement of virtually all line agencies in the process; (c) greater focus on key crosscutting themes, including governance, public sector performance, and private sector development; and (e) use of agreed indicators linked to the CMDGs to monitor progress in poverty reduction. Alongside the Rectangular Strategy these strategies provide the beginnings of a development framework focused on achieving results.
- 3.10 During the first quarter of 2004, a process to assess the first year of NPRS implementation was jointly conducted by the Royal Government and key donors. Principal observations on the SEDP2 and NPRS processes included: (a) weaknesses in costing and prioritization, (b) lack of adequate linkages between strategies and budgets and thus the need for a Medium Term Expenditure Framework; (c) need to broaden government responsibility, ownership and coordination; (d) need to build national capacity for poverty monitoring as well as evaluation of key programs and policies; and (e) further elaboration of pro-poor rural and infrastructure development strategies. Development partners often took the lead in developing the strategies, reducing government input and prioritization.
- 3.11 The RS represents a serious attempt by Government to demonstrate ownership of the development process and take the lead in prioritization. It builds on a sound diagnosis of the causes of poverty and identifies governance as the most important pre-condition to economic development. While conceptually sound, the RS appears ambitious in its growth targets given the likely significant negative impact of the phasing out of the MFA on growth – with the latter projected to slowdown to 2.3% in 2005 – and the lack of any immediate alternative to garments as a driver of growth.

C. Risks to achieving Cambodia's development objectives¹⁵

4.1 The successful implementation of the Government's Rectangular Strategy is subject to a number of risks. Cambodia is at a critical juncture as it moves away from a post-conflict situation and towards a more normal development paradigm. The full engagement of Cambodia in regional and world relations has reduced political uncertainty and contributed to improved policy predictability, but is also forcing the nation to abide by new pressures. The joint strategies of ADB, DFID, UN and World Bank have been designed with measures aimed at mitigating, or managing these risks:

- a. **Weak capacity in public expenditure and financial management undermines delivery of key public services and implementation of key reforms.** Inadequate capacity to raise and manage public finances is a key constraint to the Government's ability to achieve its development objectives. *Risk management:* the four partners are all working with other donors to support the Government's comprehensive public financial management reform program that incorporates systematic approaches to corruption prevention.
- b. **Inadequate incentives for the civil service, breeds corruption, constrains delivery of key public services and retards implementation of key reforms.** Low public sector salaries force public servants to depend on unofficial charges or other income earning opportunities to secure a living wage, constraining delivery of public services, and fuelling corruption. *Risk management:* The four partners are supporting improved practice for salary incentives and pay reform in programmes they support. The four partners will also contribute to donor efforts to more effectively support Public Administration Reform by Government.
- c. **Cambodia's global competitiveness is fragile.** Cambodia's economy is small and vulnerable to shocks. Recent growth has been heavily dependent on a few sectors such as garments and tourism, which are vulnerable to adverse changes in the global market and political conditions. If

Cambodia is unable to diversify and broaden its competitiveness, prospects for economic growth and poverty reduction could be seriously undermined. *Risk management:* The joint strategies are designed to collectively mitigate this risk by focusing assistance on improving agriculture sector productivity and its market orientation, infrastructure service provision, financial sector development and creating the enabling environment for private sector growth in general, and small and medium-sized enterprises in particular.

- d. **Donor coordination does not improve, and transaction costs for the Government increases.** Better donor coordination must move beyond better relations and co-ordination discussions into enhanced impact on the ground. There is also a risk that the four organizations work better together to the exclusion of working better with other donors. *Risk management:* the four agencies are committed to being inclusive, with better working between themselves being only part of better working between all donors in Cambodia. Recent initiatives at restructuring donor co-ordination structures and on harmonizing donor procedures are also meant to minimize these risks and improve the effectiveness of aid delivery.
- e. **The various governance initiatives fall short of expectations.** There is clear recognition among the Government and development partners that improving governance is essential for improved development effectiveness. Most development partners have increased their focus on governance and have introduced projects and programs in this area to help build government capacity to govern itself well, as well as mechanisms to boost public accountability. However governance reforms are a long and complex process that require deep and meaningful reforms in institutions, consensus, strong internal conviction and ownership. This will not be easy and there may be a temptation to substitute process for genuine reforms, if the commitment to reforms is weak. *Risk management:* the assistance provided by the four

¹⁵ Risks A-F are shared with ADB, UN and World Bank

institutions will be conditioned on the adequacy of the reform effort in that the nature and volume of assistance will be clearly linked to progress on reforms. The four partners will also speak with one voice

- f. **Increased complexity of projects causes deterioration in quality.** The quality of the portfolio of the four development institutions may deteriorate with increased complexity of issues. Policies, institutions, and human resources are relatively weaker in Cambodia than in other nations with less traumatic histories. *Risk management:* The joint strategies will help mitigate this risk by continuing to provide adequate technical assistance to support project preparation, and human resource and institutional capacity building. There will also be a greater emphasis on participatory principals involving all stakeholders in the design, implementation and monitoring of projects.
- g. **Competing interests hamper attempts to implement reforms needed for poverty reduction and growth.** The Government must manage complex and competing interests, pressures and incentives. Development partners need to develop a better understanding of the different incentives that decision-makers face to help the Government of Cambodia manage competing interests and implement the reforms needed to tackle poverty and promote growth. *Risk management:* we will work with other partners to support efforts to build the accountability of Government to the citizens of Cambodia.

- h. **Political instability leads to violence, instability or a return to conflict.** Cambodia has suffered from conflict for many years of its history and since 1998, the Government has successfully maintained peace. Commune Council elections in 2002 and national elections in 2003 went well with decreased violence. Political uncertainty remains a risk as shown by the long period of negotiations to form a new Government, but the relatively low level of violence during this period is encouraging. *Risk management:* Continued support for delivery of growth and services for poor people will help further diminish this risk. Ongoing support for decentralisation and other efforts to improve accountability are also important.
- i. **Corruption or mismanagement leads to resources being diverted from their intended purpose.** The Prime Minister has acknowledged that corruption remains an important problem in Cambodia and has stated his intent to combat corruption vigorously. There have been recent cases of donor resources being misused. *Risk management:* We and other donors ensure that all programmes have in place rigorous mechanisms for monitoring and evaluation to reduce the risks of donor resource being misused. We are seeking to strengthen the Government's systems for financial management to reduce risks of misappropriation of their resources as well as those of donors. We are also seeking to support efforts to tackle low public sector salaries that require public servants to have alternative sources of income.

RISK MATRIX

	Impact		
Probability ↓	Low	Medium	High
Low		D (donor co-ordination) I (diversion of funds)	H (conflict)
Medium	F (complexity of programmes)		
High		A (public financial management) E (governance reforms fail to deliver)	B (weak public sector incentives) C (competitiveness) G (competing interests hamper reforms)

D. Lessons learned

5.1 As part of the joint country strategy process, ADB, UN and World Bank identified lessons from our collective experience in Cambodia. We also used joint consultations with Government, the private sector and civil society representatives to determine how we could improve the effectiveness of development in Cambodia.

5.2 One key lesson was that **poorly harmonised donor dialogue and inadequately coordinated donor assistance has failed to build capacity** in government or deliver pro poor reform. We translated the lessons into Partnership Principles' to guide and improve our ways of working with other stakeholders in Cambodia, and to inform the broader harmonisation effort (see box 5.a). During the preparation of this CAP we have

Box 5.a Asian Development Bank, DFID, UN, World Bank principles for working in Cambodia

A: Principles for how we will work with Government

- Build and maintain our understanding of Cambodia's development context and base our engagement on this knowledge.
- Develop deep understanding of the incentives and institutions in each sector we engage in, and to design our support based on this knowledge.
- Build capacity in Government to lead and implement its development agenda.
- Listen to Government's own development agenda and to base our dialogue on this.
- Work with Government to identify selective priorities and align our strategies around these.
- Ensure Government has commitment and ownership before providing support
- Be realistic in our expectation, exercise patience, and take a long-term perspective

B: Principles for how we will work with other donors

- Invest time and effort into understanding our different mandates.
- Recognize our relative institutional strengths and build on them.
- Work in partnership, resolving differences and sustaining trust.
- Build and sustain enough trust to represent each other's interests to other partners
- Share information in a spirit of openness
- Communicate and maintain common messages to Government.
- Ensure there is coherence between our field office and HQ-led in-country engagement.
- Coordinate and harmonize our activities in sectors we support.

C: Principles for how we will work with civil society

- Work in complementary ways by respecting each other's mandates, priorities, constraints and comparative advantages
- Take all opportunities to build trust and respect
- Use all available opportunities to consult each other and explore concerns in order to develop a joint and shared agenda – so that we are clear on our objectives and roles.
- Work for better transparency, communication and information sharing – particularly bearing in mind language barriers
- Work with a willingness to find common solutions and with a commitment to consensus building. Speak with one voice when we agree and don't ambush each other when we don't agree.
- Work together more strategically so that long-term support builds capacity for Khmer NGOs.
- Identify ways to work together on all stages of projects and, where appropriate, to scale up successful pilots.
- Recognise that CSOs/NGOs are only a part of civil society and that both groups need to work in ways that recognise that there are other stakeholders and that broaden and deepen legitimacy.
- Make a joint commitment to listening to the voices of the poor and providing feedback to communities after consultations: this is their right.

also contributed to broader harmonisation processes including signing the Cambodia Declaration¹⁶ on improved donor behaviour.

- 5.3 There is a need to integrate a **deeper understanding of Cambodia's political, economic and social realities within programme planning**. The failure to base both sector and government wide reform programmes on a deep understanding of individual incentives and institutional cultures has resulted in weak impact. We have begun to deepen these understandings through detailed work to define what incentives exist for changes that will benefit the poor and through sector specific processes that place institutional dynamics at

the core of design (e.g. health and PFM). This work has highlighted the importance of improving governance as critical for Cambodia's future.

- 5.4 For donor-supported programmes to succeed in the longer term, a **stronger focus on building Government ownership and commitment is required**. Many development plans and programmes have been donor driven and the results have been localised, weak and short lived. The reformed Government-donor Technical Working Group structure, which is increasingly Government led, will provide a platform for strengthening this ownership.

Box 5.b: Prioritising governance reforms: strengthening the capabilities of government and strengthening citizenship

We believe that the Government is at a crossroads. If it focuses on implementing the most critical reforms in governance and in parallel helps to build its citizens' ability to demand improvements, it will set in motion a self-reinforcing cycle that promotes social and economic development. If the Government does not grasp this opportunity, it will fail to reduce poverty and Cambodia will lag further behind her neighbours socially and economically.

There are two mutually reinforcing areas where capabilities need to be strengthened – building capabilities of government and building demand for effective governance.

Helping to strengthen government capabilities

The Royal Government of Cambodia faces an enormous governance challenge. Identifying a manageable number of achievable priorities will be crucial. ADB, DFID, UN and World Bank propose to support an approach to governance that tackles the reform agenda strategically and sequentially, one that prioritizes those reforms that are a requisite for building other capabilities. ADB, DFID, UN and World Bank are committed to helping Government and its partners to carry out this prioritization and sequencing, and to align our programmes to support achievement of these reforms. From our assessment and consultations with a broad range of Cambodian stakeholders, we believe that we can be most effective in supporting the following areas of reform over the next three to five years:

- **public asset, expenditure and financial management:** enhanced capacity to manage state assets, raise revenue and effectively allocate, utilise and account for public funds.
- **effective use of public sector human resources:** including improving performance management of the civil service, increasing public sector salaries towards a living wage and introducing incentives for more demand-responsive public management of services and assets.

Helping to strengthen demand for effective governance

However, key governance reforms leading to sustained improvements in public management of services and assets are unlikely to take root without increased demand from citizens, from civil society and the private sector at national and local levels. Strengthening the capabilities of these groups is therefore the other critical priority for improving governance:

- **private sector development:** critical to reducing poverty, but also to enable the rise of entrepreneurs who will have the incentive and ability to promote conditions for long-term economic growth.
- equitable and secure **access to natural resources** is needed to provide the majority of rural people with sufficiently secure livelihoods to enable them to make claims on the state for services as citizens and not clients.
- Accountable and effective **local governance** structures can provide opportunities for poor people to voice their interests and increase government responsiveness to rural needs.

¹⁶ Text available at ????????

- 5.5 **Donors will need to work with Government to identify achievable development priorities and align our support behind them.** Development partners have had unrealistic expectations of what can be achieved and in what timeframe. Government has not fully articulated clear priorities for reform and resource allocation. The proposed 2006-10 development plan provides an opportunity to correct this.
- 5.6 Donors have a role to play in **supporting domestic constituencies for reform.** Although a relatively recent democracy, there are increasing demands for good governance within Cambodian society that will ultimately provide the basis for transparent and accountable government. We need to support and strengthen this accountability.
- 5.7 DFID conducted an independent review of the implementation of our Country Strategy 2000-2003. The key findings are found in box 5.c below.

Box 5.c: Findings from DFID Country Evaluation, July 2004

The overall judgement of the evaluation was that DFID had made a positive contribution in a difficult environment. However, the evaluators found it more difficult to show development impact, although they did say that “to a large extent, this may be more a problem of measurement and attribution than of achievement.

The other findings were:

- That DFID's small in-country presence had been important to achieving impact
- That DFID lacked an effective framework for monitoring and evaluation of the Cambodia programme
- DFID had been particularly influential at promoting better donor coordination
- The 2000 CSP focus on working through the multilaterals should be broadened to allow work with other development partners in the future

Part 2 – UK assistance plans

E. How we will work in Cambodia

- 6.1 The joint analysis of current development trends and issues (section A) provides the basis for all four agencies' objectives in Cambodia. On current projections, Cambodia is **not going to meet the majority of the MDGs** (section 2.11). Government and development partners agree poor **governance is the key constraint** to accelerating progress on off-track MDGs (section 3.4). Poor governance is hampering both economic growth and poverty reduction. Two key areas of governance need strengthening and will be mutually reinforcing in promoting progress on pro poor reform: strengthening the capabilities of government and strengthening citizenship (box 5b).
- 6.2 Cambodia receives large amounts of development assistance – pledges for the next year from donors total \$504 million. However donor assistance could achieve much more if it were used better. Maximising the effectiveness of all development assistance is an important objective of DFID in Cambodia (box 6a).

BOX 6a: Maximizing development effectiveness

In order to maximise the impact of development resources in Cambodia we will support:

- Capable **Government systems** that can deliver, including capacity to raise, manage, allocate and account for resources and a stronger human resource base with increased incentives to perform;
- Stronger **accountability** of the Government to its people including a stronger, more effective civil society and reduced corruption;
- Fully **harmonised donor assistance** supporting Government priorities and systems, with much greater pooling of financial and human resources by donors.

- 6.3 DFID will push for major changes in the way donors provide assistance as part of realising a long-term vision for better assistance in South East Asia. Cambodia suffers from too many separate donors, each with their own ideas and priorities, and too many different projects and initiatives. DFID will seek to systematically

merge functions and resources with donor partners to increase the quality of the support donors collectively provide to Government. This will reduce the number of different channels and voices that Government must manage and enable us to better support Government priorities. By 2011, we intend this process of merging functions with other donors to end the need for DFID to have a separate bilateral programme. After this date, DFID will be able to contribute to development in Cambodia through its financial support to the multilateral agencies or multi-donor offices. This will deliver on the commitment made by DFID in 2000 to have a separate bilateral programme for no more than 10 years.

DFID's objectives in Cambodia

- 6.4 For there to be any opportunity of Cambodia achieving the MDGs by 2015, donors will need to support implementation of an ambitious and long-term governance reform agenda as well as programmes to directly address off-track MDGs. Poverty levels are high (particularly in rural areas) (see section 2.7) and government lacks the immediate resources to deliver its programmes (see section 3.5 & 3.6).
- 6.5 DFID's objectives focus on improving development effectiveness including support to off-track MDGs through Government-led programmes. DFID's approach responds to feedback from partners that DFID resources are most appreciated when they are delivered responsively and where they contribute to stronger development partnerships – particularly within the donor community and with civil society. DFID's objectives for the life of this Country Assistance Plan are summarised in box 6.b.
- 6.6 DFID has selected its priorities in partnership with the ADB, United Nations and World Bank. This has led to a deliberate choice of certain areas where all the partners will work together and other areas where one or two will work separately. This division aims to ensure that all priorities (including off-track MDGs) are adequately resourced and have leadership from within the donor community. For example, discussions amongst the partners determined that the ADB would support efforts to address rural water and sanitation issues whilst the

World Bank would support urban water and sanitation. Our partnership will constantly review resource issues to ensure no MDGs go under-supported. All priorities fit with Government objectives, as articulated in its strategy documents.

- 6.7 Promoting broader-based economic growth is critical to achieving the MDGs in Cambodia. Both the ADB and World Bank have a strong engagement and comparative advantage on growth issues, for example through support to infrastructure, investment, regional trade integration and private sector development. Although growth will be an important part of our work on livelihoods DFID has less of a comparative advantage and has chosen to focus on other areas.
- 6.8 Cutting across these areas (and all our objectives) is an emphasis on improving the development system's focus on the poor and excluded. Particularly we will focus on strengthening the responsiveness of the development system to excluded groups (e.g. through gender policy work) and on ensuring that development programming delivers benefits to the poorest and most vulnerable (e.g. people living with HIV and AIDS). DFID will continue its long-standing support for tackling HIV and AIDS in

Box 6.b: A summary of DFID's objectives in Cambodia

- 1) **Contribute to rapid increases in the impact of development resources in Cambodia by:**
 - i. Supporting Government efforts to improve public financial management and accountability
 - ii. Stronger accountability of Government to its citizens
 - iii. Applying best practice in donor assistance to Cambodia
- 2) **Responsive, accountable and effective local government** for all people, especially the poor and socially excluded
- 3) **Support Government and civil society to strengthen the livelihoods of poor people**
- 4) **Increased access to health services and information**

Helping the development system to deliver better to the poorest and most vulnerable will be a crosscutting concern. DFID will continue to address HIV and AIDS through all its objectives and through continued focused support to tackle the epidemic.

Cambodia.

Objective 1: Contribute to rapid increases in the impact of development resources in Cambodia

- 6.9 Over the next three years, DFID will seek to contribute to improving each of the elements of development effectiveness set out in box 6.a. We will support improvements to Government systems and public accountability and will also promote major changes in the way donors provide aid to Cambodia.
- i. **Supporting Government efforts to improve public financial management and accountability**
- 6.10 Strengthening the Government's ability to manage its financial resources is vital to the ability of the RGC to target poverty reduction and deliver services. DFID will, with other donors, support the Government's own agenda for improving the management of public finances. These reforms, launched by the Prime Minister, will put in place 'platforms' of changes to progressively deliver improvements with each platform building on the last to ensure a realistic and achievable pace of reform.
- 6.11 DFID has pushed hard with other donors to provide pooled, flexible support to help Government implement its reform programme and stay firmly in the driving seat. DFID, with the World Bank, AusAid and the EC are pooling resources that the Government will draw on to implement its reform programme.
- ii. **Stronger accountability of Government to its citizens**
- 6.12 DFID recognises that pressure for reform and measures for development success must ultimately come from the Cambodian citizenship and not from donors. A more accountable government is not only more likely to be successful at leading and delivering reform and critical services as a bilateral donor, but is also more likely to develop a more secure climate for investment. As a bilateral with expertise in social and political change DFID is recognised as having capacity to offer support to civil society. DFID will work in partnership with others to support citizens in accessing information on their rights within the development system and expressing their views about the progress of reform.

iii. **Applying best practice in donor assistance to Cambodia**

- 6.13 Government leadership of reforms and delivery will be critical to improving governance and achieving the MDGs in Cambodia. This will require changes to donor practices to give Government the space to lead reform whilst providing effective support and promoting accountability of Government to the Cambodian people. Despite a lot of progress on harmonising donor programmes over recent years, donor behaviour in Cambodia falls significantly short of best practice set out by the OECD Development Assistance Committee in Paris. We are determined to work across all our programmes to make rapid progress at applying best practice to increase the impact of development assistance in Cambodia, including more efficient and effective technical assistance. One of the most important steps in achieving this will be contributing to successfully implementing the Government's Action Plan for Harmonisation and Alignment and supporting the newly established Government, donor and civil society co-ordination mechanisms.
- 6.14 DFID recognises both the mandate and resources of the larger multilateral organisations in their relationships with government. DFID recognises that by working in support of the multilaterals it can increase its own impact and reduce transaction costs for other development partners – particularly government. DFID will seek to work with multilaterals to strengthen development effectiveness in Cambodia both through the provision of direct financial and human resources to them. However, we are looking to harmonise with all donors including pooling resources with other bilaterals.
- 6.15 One of the donor practices that needs to change is the provision of ad hoc salary supplements. DFID is engaged in pilot approaches to reforming salary supplements in health and public financial management. In both areas, we are supporting merit-based pay approaches that are being seen as pilots for work in other sectors. We will continue to support moves to Government-led mechanisms for paying public servants across all the areas in which we work.

Objective 2: Responsive, accountable and effective local government for all people, especially the poor and socially excluded

- 6.16 The Government has just published its new Strategic Framework for Decentralisation and Deconcentration. This framework is ambitious and proposes far-reaching changes to the structure and functions of different levels of Government. DFID will support the process of implementing this Framework and the provision of decentralised services and accountability mechanisms that respond to the needs of poor people and the socially excluded.
- 6.17 Strong Government leadership in decentralisation and deconcentration needs to be matched by a move to fully harmonised donor arrangements for supporting the RGC's future reform agenda. DFID currently co-chairs the Government-donor Technical Working Group on Decentralisation and Deconcentration and will continue to play a leading role in donor discussions on how best to support the implementation of the Government's Framework. DFID will work with donor partners to ensure that the best possible support is provided to Government and other stakeholders to deliver the Government's vision for local government reform.

Objective 3: Support Government and civil society to strengthen the livelihoods of poor people

- 6.18 Support to rural livelihoods is critical to progress against the poverty MDG. The livelihoods of poor people are crucially dependent on the patterns of ownership, access and management of land and natural resources more broadly. Providing people with greater security in their ownership of assets such as land will be critical to encouraging greater rural investment and economic growth.
- 6.19 DFID plans to support a Multi-donor Livelihoods Facility to pool funding, administrative and advisory inputs to rural livelihoods and natural resources programmes. DFID and DANIDA are taking the initial lead on setting up this facility. It is proposed that the DFID Rural Livelihood Adviser relocates to this facility during 2005. This facility will replace separate programmes and

voices of the contributing donors in livelihoods, making better use of donor resources and reducing transaction costs on Government and other stakeholders. The joint donor office will support the development and implementation of Government-led approaches to strengthening livelihoods.

- 6.20 The facility will design and manage programmes on behalf of contributing donors. Initially, it is likely to include support to strengthening the Government's management of aquatic resources; supporting and expanding current work by other donors on land reform in Cambodia; and supporting civil society to help people secure access to natural resources.

Objective 4: Increased access to health services and information

- 6.21 Under its existing programme, which will continue throughout the CAP period, DFID is providing support to the government alongside the WB and ADB and others for improved sector performance and more accessible and better quality health services, especially for poor people and women. We will continue to work in close collaboration with WHO, other UN partners, communities, NGOs and civil society to build a sector wide approach and to support a strengthened multisectoral national response to HIV and AIDS.
- 6.22 We will focus on helping the government to implement its **Health Sector Strategic Plan** (2003 – 2007) which focuses on achieving the health and poverty MDGs. Over this period, we will also assist government to develop a robust evidence base for evaluating progress, developing future strategies and evaluating alternative approaches to delivery. In addition we will support people in Cambodia, especially the poor, vulnerable and excluded to **demand and access safe and effective care**, protect their own health and reduce the potentially catastrophic costs of health care.
- 6.23 Progress in the health sector is critically dependent on improvements in public financial management and the effectiveness of work on public expenditure and financial management. Progress will be measured, through for example public expenditure tracking in the health sector. We will also be developing better ways

to **improve accountability for health services** in our work in local governance. In rural livelihoods we will ensure that the design stage of new programmes, takes full account of the poverty impact of health spending.

- 6.24 **Water and sanitation** are critical areas for achieving health outcomes that have not received sufficient attention. A positive move is the decision by the ADB to work on rural water and sanitation and World Bank to work on these issues in urban areas. However, we are assessing the needs in consultation with donor partners and other stakeholders. We will consider if more resources are needed and to ensure that water and sanitation issues are given the attention and support they need.
- 6.25 In summary, to increase access to health services and information, DFID will:
- ii) Help strengthen Ministry of Health's **capacity to define, plan and manage** the health sector
 - ii) Support **innovative mechanisms to improve access to services and health information** with a particular focus on reducing maternal mortality and halting the spread of HIV and AIDS
 - iii) Support wider participation (especially from commune councils, other community level groups and civil society) to **improve accountability for health services**.
 - iv) Work with donor partners to ensure that adequate resources are available to engage on policy issues and to support delivery of **water and sanitation to poor people**.

F. Modalities for assistance

- 7.1 There are two key drivers behind the choice of channels for DFID assistance. The first is the push to country-led approaches with Government taking the lead in reform processes, including consulting with other stakeholders, with donors in a supporting role. In Cambodia, we are seeking to move with other donors to **sector-wide approaches** to help Government implement its sector-strategies in key areas for poverty reduction. DFID is supporting moves in this direction in health, public financial management, local governance and livelihoods.
- 7.2 We are undertaking preparatory work for introducing poverty reduction budget support as one of the aid instruments we use in Cambodia. Poverty reduction budget support is likely to become an important mechanism for financing development in Cambodia in the future. The World Bank is planning a Poverty Reduction Support Operation (PRSO) in 2006 and we are assessing the case for co-financing – we will seek to ensure that any support to a PRSO aims to address core governance issues (particularly financial management and accountability) and builds on government's own results framework rather than imposing external conditionalities.
- 7.3 In addition to helping the Government take the lead, we will also provide support to **civil society** to strengthen the accountability of Government to citizens – including support to create demand for better services.
- 7.4 The second driver is harmonisation among donors which, over the next three years, will include merging donor human resources in multi-donor offices. Across all our programmes, we are seeking to **pool funding with other donors** to maximise effectiveness and to reduce the transaction costs on Government of multiple donor funding channels. In livelihoods we are designing a multi-donor office, initially with DANIDA, that will pool the resources of participating donors to enable a larger, more effective response with lower transaction costs to Government and others stakeholders.
- 7.5 We will continue to undertake strategic **analytical work** to explore ways to provide better support to Cambodia. In most cases such support will be carried out in partnership with other donors and Government. In all cases we will share the products widely.

G. Allocating financial and human resources

8.1 Cambodia receives significant levels of assistance from the international community. Like most least developed countries, Cambodia has limited domestic resources and development assistance accounts for most of Cambodia's public investment. In 2002, Cambodia received \$487 million from the international community in development assistance or \$39 per person per year. In terms of aid per person, Cambodia receives similar levels to other least developed countries with similar population (see table 8.a), but nevertheless it receives much larger levels of aid per capita than large countries such as Vietnam or India, reflecting its post-conflict needs.

Table 8.a: Aid per capita for selected countries with comparable levels of poverty and population

Country	Population	GNI per capita	Aid per capita
Zambia	10,244,000	340	63
Malawi	10,743,000	160	35
Mali	11,374,000	240	42
Niger	11,425,000	180	26
Cambodia	13,172,000	290	37
Cameroon	15,769,000	570	40
Mozambique	18,438,000	200	112
Ghana	19,908,290	280	33

8.2 However, there is evidence to suggest that much of the aid Cambodia receives is not used as effectively as it should be and there is an urgent need to increase development effectiveness (see section E). Therefore, DFID's greatest contribution will come from supporting better use of the total donor funds, not just the impact of its own money. We believe a modest increase in our assistance to Cambodia during the life of this document is justified in order to enable us to play an influential role in shaping the way donors provide assistance. Demonstrating our willingness to back more effective approaches has been an important strategy in promoting more effective use of aid instruments. Taking

all these factors together, if the Government delivers on its planned reform programmes, we plan a modest increase the size of our programme over the life of this Country Assistance Plan. The table below gives an indication of predicted expenditure up to 2007/08 (all figures are indicative only).

	2005/06	2006/07	2007/08
Areas of support	Approximate support planned (£million)		
Public financial management, accountability and development effectiveness	1.5	1.5	2.0
Local governance	2.7	2.7	2.7
Livelihoods	0.5	2.0	3.0
Health	2.3	2.3	2.3
HIV and AIDS	4.0	4.0	4.0
Total	11.0	12.5	14.0

8.3 We will manage a modest increase in programme expenditure without further strengthening our staff resources. We will do this by pooling resources with other donors to increase efficiency, working through Government delivery channels wherever possible, and designing programmes to be administratively simple and efficient. We will increasingly share our advisory staff and administrative support with other donors, through the implementation of joint programming.

- 8.4 The DFID Cambodia team will continue to comprise of some staff based in Phnom Penh and some based in Bangkok or other parts of the region. We will continue to focus our staff resources (either as part of DFID or as part of joint donor offices / programmes) on policy dialogue, harmonisation and delivering effective support to Government, minimising the staff resources applied to internal administration. We have recently made some modest additions to our capacity in Phnom Penh but as we merge functions and staff resources with other donors, we expect the separate DFID team to reduce in size over the life of this CAP aiming for the point where DFID core staff are focused on monitoring and supporting the implementation of multi-donor programmes and engaging in critical policy dialogue on harmonisation and alignment.
- 8.5 Excellent working relations with Foreign and Commonwealth Office (FCO) colleagues in the British Embassy in Phnom Penh and London are critical to achieving our objectives. We are merging more support functions with the Embassy to maximise efficiency savings and will continue to work closely with FCO on policy issues.

Annex 2

Process for producing this Country Assistance Plan – Note produced by UN country team



DFID



Scaling-up Action on the Rome Agenda: The "Quadripartite Initiative" in Cambodia

In June 2004 the UN Country Team in Cambodia decided to join the World Bank, the Asian Development Bank and DFID's joint planning exercise, which they had been working on for over a year. The initiative produced a common assessment of the country development challenges and risks; created an opportunity to compare programmes identifying gaps, avoiding duplications and building synergies; reduced transaction costs holding joint consultation meetings with all stakeholders (government, donors, civil society, and private sector) and future joint monitoring meetings; and last but not least established "partnership principles" in working together and with the government and civil society.

The initiative was extremely well received by our partners:

- » *Government* applauded the effort as a catalyst to further harmonizing donor development assistance in Cambodia and make it consistent with the government's political platform and development strategy, ensuring national ownership.
- » *Civil Society and Private Sector* seized the opportunity of a joint dialogue with four international partners to air their concerns and build stronger partnerships.
- » *Other donors* expressed great interest in the initiative and some asked to share the common assessment and/or join the mid-term reviews and joint programming.

Background: a step-by-step account

Although donor agencies in Cambodia have made efforts to share information and even collaborate in some sectors through the Consultative Group (CG) mechanism, planning and programming efforts have been undertaken separately, with little effective inter-agency collaboration. In addition, overall coordination of donor activities by the Royal Cambodian Government has been weak. Overlapping national planning exercises supported by ADB (the Second Socio-Economic Development Plan, or SEDP II) and the World Bank Group (the National Poverty Reduction Strategy, or NPRS) highlighted the need for increased collaboration, as well as for enhanced country ownership of development planning. For its part, DFID, as a bilateral donor, sought to increase the impact of its development assistance to Cambodia by forging a strategic partnership with other of Cambodia's key donor agencies.

When it became clear that ADB, DFID, and the World Bank Group shared a common timeframe for the preparation of new country strategies, country teams from the three agencies decided to make a concerted effort to coordinate their strategic planning activities in Cambodia, using the Cambodia National Poverty Reduction Strategy, adopted by the Government in early 2003, as an overall framework. Each of the agencies' respective headquarters endorsed the notion of greater interagency collaboration, although with no clear idea as to the steps that might be involved in pursuing such collaboration, or the end results of such efforts in Cambodia.

The three agencies held a first retreat to develop a common understanding of Cambodia's development challenges and to determine how such an understanding could be reflected in a coordinated manner in each agency's country strategy for Cambodia. Each agency also shared their perception of their own and others' comparative advantage. They also reviewed past development experience

in Cambodia. Based on these lessons the agencies developed a set of principles for successful partnership working.. Consultation workshops were then held with stakeholders to inform them about the initiative, to share understanding of lessons learned, to identify achievable results for the three agencies' programmes and discuss ways to achieve them.

In the meantime, the UNCT in Cambodia had agreed in March 2004 that given the quite substantive analytical work already reflected in several national planning documents, a separate UN exercise for the preparation of a CCA would not be needed. The three partners' initiative of drafting a common assessment clearly went in the same direction. A link was quickly established and the UN system decided, under the leadership of the newly appointed Resident Coordinator, to join the World Bank, the ADB and DFID in this joint planning exercise. The UN system programme cycle was a year behind the other three partner agencies. However, the political deadlock that followed the July 2003 elections retarded the three agencies planning processes and enabled the UN system to join their initiative.

On 15 July 2004 a new government finally was established after a year-long delay and it was possible for the four partners to enter into formal discussions with the Government about both the common analysis, as well as the elements of individual agency country programs. The new government also presented its "Rectangular Development Strategy for Growth, Employment, Equity, and Efficiency", a tool to implement its political platform and to meet the Cambodia Millennium Development Goals (CMDGs). The partners naturally agreed that this represented the basis for the development of their own country programmes.

As an extension of the teamwork that had been developed through the joint strategy process, the identification and elaboration of agency projects and programmes was undertaken in an open and consultative manner, with the agencies freely sharing information and giving particular attention to effective division of labour as well as potential synergies through collaborative action. As a result of such discussion, decisions were made for one agency to take a lead in a particular sector, or to withdraw from a sector in deference to another partner's stronger program of support. In some key sectors, the agencies agreed to combine efforts, with attention as to how to maximize each others' contributions.

The four partners then held a series of workshops with all stakeholders (CSOs, private sector, other donors and the government) to share the joint ADB-DFID-UN-World Bank assessment of Cambodia's development context, to provide feedback on stakeholders' input from the earlier consultations, and to introduce the planned joint support to the national development strategy.

As the new country programs are approved and implementation of projects and other activities begins, the four partner agencies have agreed to meet at least every six months to jointly review progress against planned outcomes. Such review meetings also will provide an opportunity to reflect on the partnership, including adherence to the partnership principles as well as ways to deepen or strengthen collaborative action. Once a year, the four agencies will seek feedback from the Government and other stakeholders on progress with implementation of the partnership.

Annex 3 Programme expenditure profile 2000/01 – 2002/03

Sectors	Expenditure (£ million)		
	2000/01	2001/02	2002/03
Health	1.1	0.69	0.35
HIV and AIDS	0.45	0.89	1.0
Decentralisation and Rural Livelihoods	0.9	2.1	6.3
Urban Poverty I & II	0.36	0.71	
Poverty Reduction Support Programme			0.06
Others*	0.60	0.53	0.28
Total	3.41	4.92	7.99

* This includes Education and Small Grant Scheme

[Figures on Information and Civil Society Department and the Conflict and humanitarian Affairs Department Funded projects are to be added]

