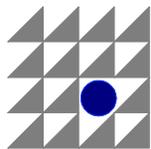


UNDP

Cambodia
**Evaluation of Fiscal
Decentralization Support
Project (FDSP)**

Final Report

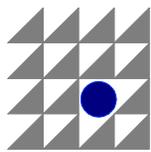
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Acronyms and Abbreviations

ADB	Asian Development Bank
AusAID	Australian Agency for International Development
CDRI	Cambodia Development Research Institute
C/S	Commune/Sangkat
DANIDA	Danish International Development Agency
D & D	Decentralization and Deconcentration
DFID	Department for International Development (UK)
DLF	Department of Local Finance
DLA	Department of Local Administration
DSP	Decentralization Support Program
EAP	External Advisory Panel
EC	European Commission
EFI	Economics and Finance Institute
Excomm	Executive Committee
FDSP	Fiscal Decentralization Support Program
IDLDD	Innovations for Decentralization and Local Development
IMF	International Monetary Fund
IMC	Inter-ministerial Committee
MDTF	Multi Donor Trust Fund
MEF	Ministry of Economy and Finance
MoI	Ministry of Interior
MTBF	Medium Term Budget Framework
NCDD	National Committee to Support Decentralization and Deconcentration
NCSC	National Committee to Support Communes
NEX	National Execution
PFMRP	Public Finance Management Reform Program
PFMTWG	Public Finance Management Technical Working Group
PSDD	Program to Support Decentralization and Deconcentration
RGC	Royal Government of Cambodia
SIDA	Swedish International Development Agency
SNDD	Sub-national Democratic Development Program
TOR	Terms of Reference
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme

Executive Summary

This report details the evaluation of the Fiscal Decentralization Support Project (FDSP) undertaken during the period 9-26 May 2007. UNDP Cambodia, with cooperation of UNCDF, commissioned the evaluation. It assesses the environment and conditions under which the project was implemented, the accomplishment and sustainable results of the project, some aspects of the program management by both the counterpart Royal Government of Cambodia (RGC) Ministry of Economy and Finance (MEF) and the implementation of the project by United Nations Capital Development Fund (UNCDF) and the management arrangements for the jointly funded United Nations Development Programme (UNDP) and the UNCDF.

Chapter 1 provides an introduction and background to the FDSP. The UNDP and UNCDF have over several years actively supported the decentralization process in Cambodia and the FDSP represented a new partnership arrangement to further decentralization. The FDSP was incorporated as a sub component of an existing Decentralization Support Project (DSP). The Ministry of Economy and Finance was designated the National Execution (NEX) agent and the UNCDF was the implementing agency for the project based on the Project Document developed for the FDSP. This evaluation covers only the FDSP sub component of the larger DSP and not the other components included in that program.

The evaluation was accomplished by a review of an extensive number of documents and reports on the project as well as interviews with the UNDP/UNCDF project staff and consultants, staff of the MEF and Ministry of Interior (MoI), provincial, district and commune officials, and the interested donor organizations. A field trip was taken to Siem Reap, Cambodia province to meet with Provincial, District and Commune level officials to assess the activities of the project at these government levels.

The context and environment in which the decentralization policies and processes are being undertaken is described in Chapter 2. The important present feature of the policy environment is the National Decentralization and Deconcentration (D & D) Strategic Framework that was issued in 2005. This Strategic Framework had an important impact on the orientation for the FDSP following its issuance and the development of a work plan in 2006. The Strategic Framework reoriented the national level focus from the commune level and broadened the national level focus on decentralization to include provinces and districts. The only existing legal framework is directed toward the commune level, which still remains the main basis for assignment of sub-national level responsibilities. Consequently, the D & D still remains on a conceptual basis rather than a full legal framework needed for such a complex system.

An important feature of the environment and possibility for further efforts toward decentralization is the complex organization arrangements and actors involved in the effort. The MoI is providing the organizational framework for the National Committee for Decentralization and Deconcentration (NCDD) as the main actor in developing the policy level frameworks, such as the Organic Law, and the supporting organizational structures for the NCDD, such as financial subcommittee to deal with fiscal decentralization issues. The organizational arrangement has not been put into effect to a satisfactory level and the progress toward drafting an Organic Law has been largely unsuccessful. This situation had important consequences on the accomplishment of activities that were expected from the FDSP.

There are many challenges to be faced in promoting the D & D effort and these are detailed in the last part of Chapter 2. These include the development of a national program for D & D, progress on the development of the Organic Law to provide the legal framework, creation of

intermediate tier of government at the provincial/district level, the lack of capacity at the commune level to provide services, no clear expenditure assignment or revenue sources at the sub-national levels, among several other challenges that are identified in the section.

The overall assessment of the accomplishment and results of the FDSP are presented in Chapter 3. This assessment is based on examining the results of the three components of the FDSP as developed from the work plan in 2006, reflecting the new situation and environment created by the Strategic Framework of 2005. The assessment also addresses some of the impacts on the capacity building and knowledge transfer activities of the project in several organizations of the MEF.

The accomplishments of the components indicate some mixed results on an overall project basis. A table is provided at the end of this executive summary that provides the details on the achievements of the project. There were some significant accomplishments of the project as indicated in the summary. However, a number of other activities had only partial or no success over the course of the project from 2006. The complexity of the project and the lack of formal evaluation criteria from the initiation of the project hampers making a definitive quantitative assessment of the project. Consequently, the evaluation relies more on subjective and judgmental assessments based on the review of the progress reports, policy papers and presentations, and the opinions of those interviewed who provided insights and judgments concerning the impact of the project on promoting D & D effort in Cambodia.

The evaluation indicates that 98% of the available funds will be used by the end of the project period and that a majority of the planned activities will be completed. Given the quantity and quality of the level of activity, it is the judgment of the evaluator that the project produced excellent value for money for the \$1.4m contributed by UNDP and UNCDF over this period.

Component 1, dealing with improving the capacity of the MEF to develop intergovernmental fiscal policies and fiscal decentralization, demonstrated good success through the expansion of the D & D Working Group in the MEF, the training that was developed and delivered in MEF structures, particularly the Economics and Finance Institute, and the sending of five staff to the Duke University course on Fiscal Decentralization and Local Governance. It should also be mentioned that the use of field visits by MEF staff to the provincial, district and commune level brought the actual situation and revealed problems in the transfer of funds that were also capacity building efforts with practical impacts. These field trips provided the MEF staff with the opportunity to see the impact of the policy level decisions on the actual operations of the provincial, district and commune levels. As a result of these field trips, a sub-decree was prepared that changed the timing of the allocation information to the communes to several months earlier and provided a better basis for commune to make their decisions on projects and funding for the coming fiscal year.

Achievements in Component 2, dealing with development of fiscal decentralization policy and strategies, were less successful in achieving expectations. The input to the development of the Organic Law with financial provisions was limited due to not having access to the structures of the IMC and the drafts of the Organic Law that would be necessary to provide advice and recommendations on this policy development. However, the project did develop policy studies on sub-national finance provisions, sub-national budgeting strategy and implementation schedule for fiscal decentralization which were used for discussion within the MEF PFM Working Group on D&D and in the training provided within the Ministry of Economy and Finance.” These policy documents may still be utilized if there are further developments of the decentralization policy effort. These policy papers and presentations are provided in Appendix 3 of this report. The policy papers dealing with the introduction of property related taxes and the development of

a two-tier local government system are of high quality and provide the level of information and detail to be important contributions to the policy debates on these subjects.

Component 3 achievements are rated as excellent in terms of immediate impact of the activities on improving the financial situation of the communes. The component was directed at improving the legal framework and procedures for the sub-national financial systems. Due to the field visits identified above, certain problems in the flow of funds from the national treasury to the provincial treasury and subsequent payments were identified. Efforts are underway to improve this situation so that payments for completed projects can be made in a timely fashion. The other impact of this component is the support given in increasing the resource allocations to the communes in the Commune/Sangkat Fund. The percentage of funds allocated from the national budget has been substantially increased, from 2.56% to 2.7% of the national revenues in 2008, and there are improvements in the estimation of the allocation amounts and the flow of information to the communes on what their allocation will be for the coming year. These are being implemented for the period 2008-2010 in a sub decree being issued by the RGC.

With regard to the knowledge sharing and capacity building efforts of the FDSP, there is evidence that this has been accomplished to a very high degree. The training provided to the Department of Local Finance (DLF), the Tax Department and the Economics and Finance Institute (EFI) demonstrates good results and great appreciation by those receiving this training. The overall assessment of this training provided by the Director of EFI was that it was well received by the 33 officials who attended the course. The training report is provided as Appendix 4 to this report. The technical assistance provided to the Tax Department in the areas of property tax development and the oil and gas revenue issue provided an opportunity to provide technical assistance and training not envisioned in the original work plan. The FDSP took advantage of this possibility to achieve even more than was expected in the original work plan by expanding the support to this strategically placed department of the MEF.

With the exception of the policy related activities dealing with the Organic Law and other issues, the FDSP activities should have good sustainable results for the future. The impact on the Commune/Sangkat Fund allocations is considered very positive for the future development of the communes to plan and execute their local infrastructure and service projects.

The overall assessment of the component activities for the period 2005-2006 are presented as follows:

	Fully Achieved	Partially Achieved	Not Achieved
Component 1	7	1	1
Component 2	3	3	3
Component 3	9	0	9

For the 2007 work plan activity assessment the following represents evaluation of the achievement of these activities:

	Fully Achieved	Partially Achieved	Not Achieved
Component 1	4	0	1
Component 2	1	0	1
Component 3	8	0	3

Chapter 4 provides a brief assessment of the program design and management of the project in the MEF. As indicated above, the FDSP was a NEX arrangement in which the MEF had substantial responsibilities for the development and implementation of the project. Positive elements of this assessment are the interest by the National Program Director to be actively involved in the development of the workplan and other aspects of the project. The provision of office space for the Fiscal Decentralization Advisor near the National Program Director and easy access indicates the level of support that was part of the overall project management. This arrangement is considered to be highly effective and contributed to the impacts of the FDSP on the MEF that were described above.

The implementation and management arrangements between UNDP and UNCDF are addressed in Chapter 5. A review of the situation reveals that there was not a clear definition of what each partner to this project would be responsible for or the reporting requirements. The project document indicated that UNCDF would be responsible for the implementation and funding arrangements of the project. However, there was no Memorandum of Understanding that clarified this arrangement. This lack of Memorandum and the high turnover of personnel associated with the project in both UNDP and UNCDF at the early stages of the project created a situation where the informal agreements or understandings were not clear from the beginning. This is an area where corrections and improvements should have been made but were not realized over the course of the project. Even though there were difficulties with these arrangements, there is not indication that they seriously impacted the overall success of the implementation of the technical assistance or training activities of the project.

Chapter 6 addresses the possible options for future continuation of the decentralization support by UNDP and UNCDF. UNCDF has developed a proposal for continuation of the project that would include World Bank and potential other donors to support some of the activities that are relevant to the interest of UNDP. The final details of this proposal and partnership are still under discussion.

A second option would be for UNDP to focus on continuing the successful capacity building efforts of the FDSP. This project would provide support to the Department of Local Finance, the EFI and particularly the Tax Department. This effort would focus on the revenue side of the decentralization equation and provide a long-term tax and revenue policy advisor to support the Tax Department in these areas, as well as provide the training that has already begun and should be expanded in the future.

The third option considered would be to join the Multi Donor Trust Fund (MDTF) administered by the World Bank for the larger Public Financial Management Reform Program (PFMRP) that is a comprehensive program to improve the overall public finance situation in Cambodia. There is a fiscal decentralization area within this project that UNDP could support. Also, the project requires some support for the implementation of a medium term budget framework, the

development of functional analyses with the MEF, revenue mobilization and other areas in which UNDP may be able to provide funding and technical support.

The following table provides a summarization of the achievements of the FDSP over this period of assessment. This is followed by a listing of the recommendations that are contained in the relevant chapters of the report.

Table 1

Achievements of the FDSP
<p>Fully Achieved:</p> <ul style="list-style-type: none"> • MEF D & D Working Group expanded to all eleven major departments and effectively organized to identify and research issues in FD • Substantial increase in the national revenue allocation to the communes from the C/S Fund for 208-2010 • Inclusion of FD indicator (#15) into the PFM Reform Program • Seven officials sent to the Duke University course on Fiscal Decentralization and Local Government • Increased understanding of FD through 3-week training course Designing Fiscal Decentralization Strategy for Cambodia to 33 officials • Increased capacity of the EFI to provide training from development of additional courses, such as Project Appraisal and Capital Investment Planning • Increased capacity of the Department of Local Finance through weekly training sessions and the use of field visits to examine issues related to the C/S Fund flows • Major research projects completed on Local Revenues and Commune Service Delivery with the Cambodian Research Development Institute with research papers published and conferences held on these topics • Developed recommendations incorporated into a sub decree that was enacted to improve the timing of the estimation of the funds to be allocated to the communes for better financial planning by the communes • Major policy papers on sub national budget framework, operation of the C/S Fund at District level, property related taxes and legal framework options for FD were prepared as input to national level policy making • Effective liaison with other D & D Working Groups from the donor community and the NGO sector • Development of Revenue Options Paper to contribute to the accomplishment of PFM Fiscal Decentralization Performance Indicator # 15 • Development of the capacity of the Tax Department in technical areas such as property related taxes, oil and gas revenue options. <p>These were fully achieved primarily due to the fact that these activities were within the control of the FDSP project staff and the MEF staff to accomplish.</p>

Partial Achievements:

- Limited liaison effected with the MOI/NCDD on completion of FD policy papers to be incorporated into the Organic Law
- Limited development of FD policy and implementation strategy framework papers
- Limited development of design of sub national budgeting and financial management system pending completion of Organic Law

These activities were only partially achieved due to the problems with communication and coordination with the MOI/NCDD and the organizational structures were not created by the NCDD to provide a basis for accomplishing these activities to a greater degree.

Not Achieved:

- Organization and Operation of the C/S Fund Board
- Commercial Bank Accounts for the Communes for C/S Fund
- Full set of legal frameworks for local governments to include Organic Law, local revenue law and intergovernmental transfer system and accompanying regulations on sub national budget and financial management system
- Piloting of commune service delivery activities

These activities were not achieved due to national level policy decisions that precluded their achievement or further development of these activities due to not willing to pre-empt the development of the Organic Law

Summary of Recommendations

The table below summarizes the findings of the evaluation.

Chapter 2: Recommendations	
2.3.2	Some effort needs to be made within the coming months to open this process for additional RGC ministries, national stakeholders in this process, such as the communes and NGOs, and the donor community to bring forth a national consensus on the provisions of the Organic Law and the future functions and structures of the D & D affected organizations.
2.3.3	There is a need for a more coordinated and higher profile organization structure from the NCDD that has some capacity to coordinate across the ministerial organizations to effectively manage this effort.
2.3.7	A priority area for development in the D & D process is to develop own-source revenues and other sources to the commune or higher level within a possible two-tier level of local authority structure that may be created in the future.
2.3.10	The future of the ExComm as a provincial level service provider and the financial support needed to continue this support needs to be examined
2.3.11	There is a need to further identify and account for these funds and to incorporate this into the factoring of the design of the fiscal decentralization policies and procedures in a more comprehensive central level budget and priority setting process.
2.4	The lesson to be drawn from this is that decentralization has to be supported by the political will at the highest levels and has to be part of the larger governmental agenda and reform program. If this does not occur the possibility for much progress to achieving a decentralized system will be difficult, if not impossible.
Chapter 5: Recommendations	
5.4	While these types of incentive payments have been utilized by UNDP in other projects under the name of Capacity Building Facilities, they have been very controversial and UNDP has certain guidelines on how these payment facilities should be used. The UNDP policies on these payments should be reviewed if the project should be continued and supported by RCG staff within the MEF.
Chapter 6: Recommendations	
6.3	Some consideration needs to be given as part of the development of a new FDSP successor project on the development of some approaches to improving the dialogue on the implementation of D & D, as well as fiscal decentralization.

Chapter 1 - Background and Evaluation of the Fiscal Decentralization Support Project (FDSP)

This chapter provides some of the programmatic background to the evolving of the Fiscal Decentralization Support Project (FDSP) over the past several years. The more complete and comprehensive review of the evolution of the project from initial efforts by UNDP to support the larger decentralization effort in Cambodia over the past decade is provided in the background documents reviewed for this evaluation of the FDSP. These are identified in Appendix 2 of this report.

1.1 Introduction to FDSP

The Fiscal Decentralization Support Project has been the primary project of the UNDP to support the furtherance of the public finance and intergovernmental financial system reform within the broader decentralization and deconcentration objective that overarches the UNDP programming themes in Cambodia. The FDSP is an outgrowth of earlier UNDP and UNCDF projects that have evolved over the past decade.

1.1.1 UNDP Decentralization Support Program (DSP)

The UNDP Decentralization Support Program is the broader UNDP based program for furthering the decentralization efforts in Cambodia. This program preceded the initiation of the FDSP in 2004 with two other components that were directed at providing assistance in the holding of local elections as well as the broader areas of decentralization. The DSP was structured to provide support to and through the Ministry of Interior (MoI). The relationship with the Ministry of Interior has continued for the broader development of the decentralization and deconcentration support in the areas of improving the structure, procedures and systems for implementation of the service delivery and infrastructure improvements that are implemented at the commune level through the Commune/Sangkat Fund and with the assistance to the provincial and district levels through the technical assistance and support provided through the UNDP and donor supported Project to Support Democratic Development through Decentralization and Deconcentration (PSDD). The Commune/Sangkat Fund is not the only means of supporting service delivery and infrastructure projects to the commune level. It provides the minimal level of service delivery and infrastructure support, primarily to small water and irrigation projects, some road improvements, and other facilities. The Central Ministries and the Provincial Investment Fund provide support for the larger service and infrastructure projects, with additional support coming from donor projects that are directed to specific projects in selected communes.

1.1.2 United Nations Capital Development Fund (UNCDF)

The UNCDF's involvement in supporting the decentralization effort in Cambodia originates in the 1990s. The UNCDF initiated and supported the creation of a local development fund that was a predecessor to Royal Government of Cambodia (RGC) programs that developed in later years, such as the CAREERE and Seila programs. The local development fund initiated by UNCDF provided the conceptual and practical basis for the Commune/Sangkat Fund that has provided funding to the 1,621 communes over the past several years. This Commune/Sangkat Fund has provided the basis for developing a formula based intergovernmental transfer system

from the central to local level as well as the capacity building efforts at Ministry of Economy and Finance (MEF) and commune levels to improve the public financial management reforms.

1.1.3 UNDP/UNCDF Cooperation for FDSP

The ending of the UNCDF Local Development Fund Project created an opportunity for a cooperative effort between UNDP and UNCDF to continue to support the fiscal decentralization efforts initiated by UNCDF and the UNDP within its broader Decentralization Support Project. A project document was developed and agreement was reached between UNDP and UNCDF to support a new Fiscal Decentralization Support Project as a third component of the Decentralization Support Project of the UNDP. The agreement stipulated that each side would provide funding support (UNDP in the amount of \$920,300 and UNCDF in the amount of \$570,600) and that the UNCDF would be the implementing agency for the project. The main difference from the execution of the DSP would be that the FDSP would be implemented by NEX execution within the Ministry of Economy and Finance, rather than through the Ministry of Interior as with the broader DSP.

1.1.4 Objectives of the FDSP

The objectives of the FDSP changed over time to reflect some of the major changes in the policy development areas related to the development of the decentralization and deconcentration efforts by the RGC. The early objectives as identified in 2004 were to continue to focus on the development of the commune levels, particularly to increase the commune council resources, define the responsibilities of the commune councils, and to improve the overall reform efforts focused on the commune level of administration.

The objectives were substantially reoriented in June 2005 following the issuance of the Strategic Framework for Decentralization and Deconcentration (D & D), which impacted the overall policy reform situation. The Strategic Framework developed a broader concept of the decentralization and deconcentration effort to include the possibilities for creation of greater responsibilities and authority for a provincial and district level of government and realignment of the service delivery functions consistent with these changes. Consequently, the strategic framework opened up the possibility for the intermediate tier of governments to be given authorities as well as the possibility of being a service provider based on a new system of functional assignments from the central to the commune levels.

More importantly for the objectives of the FDSP, the D & D Strategic Framework gave greater responsibility to the Ministry of Economy and Finance to impact the policy reforms in the public finance management and fiscal decentralization area. The MEF was assigned the following tasks: (1) develop the fiscal decentralization strategy, (2) improve the legal framework and procedures for sub-national financial systems, and (3) strengthen the MEF capacity for guiding and directing the intergovernmental fiscal reforms and the monitoring of the sub-national levels of government.

1.2 Evaluation Objectives of the FDSP

The evaluation objectives identified for the conduct of this mission and described in the Terms of Reference (ToR) represent a very comprehensive set of areas to be reviewed for identifying the accomplishments of the project technical areas, the management of the program resources, both human and financial, and the possible options for continuing future projects or programs to build on the results of the FDSP over the past several years.

The objectives of the FDSP evaluation are provided in the following from the ToR:

- To assist the recipient Government, beneficiaries, and the concerned co-financing partners, to understand the efficiency, effectiveness and relevance of the program, the sustainability of program results, and the level of satisfaction of program stakeholders and beneficiaries with the results;
- To review and assess the extent to which MEF, as the executing agency was able to meet the FDSP's work plan and objectives;
- To identify any constraints to achieving results and to identify their satisfaction with the results;
- To assess the effectiveness of the short and long term technical assistance provided;
- To assess the effectiveness of UNCDF's role as an implementing agency;
- To make key recommendations to UNDP and UNCDF on the need or otherwise for follow-up on the current interventions, and identify the main challenges and gaps for fiscal decentralization in the immediate and long term future that could be supported by UNDP and/or UNCDF;
- To contribute to UNCDF/UNDP learning from the experience;
- To ascertain if the implementation of the project complied with the requirements of the program document and with the UNCDF Evaluation Policy.

1.3 Scope of the Evaluation

The scope of the evaluation is based on a review of the FDSP Project Document of July 2005, and covers the period from July 2005 through the end of 2007. The evaluation is only focused on the FDSP component of the Decentralization Support Project and not the broader components relating to the support to the holding of elections and the other D & D activities of the PSDD. It is also limited to the activities within the MEF in areas of policy development support and provision of capacity building through training provided to the staff of the MEF. The evaluation examines the period from August 2006 when the Fiscal Decentralization Advisor was permanently in place and the changes to the work plan were initiated based on the new Strategic Framework for D & D that broadened the scope of the activities to the provincial and district levels of government. Prior to this period, there was a limited level of activity focused on the support to the C/S fund and research of the service delivery options at the commune level.

1.4 Methodology of the Evaluation

The evaluation of the FDSP is conducted based on extensive review of the project documents, progress reports, presentations, mission reports, and the financial information related to the project. A set of progress reports covering the period of the project from 2005 through March 2007 was provided. These progress reports were very thorough and detailed in the information that was provided on the activities of the project over this period. A report prepared in January 2007 detailed in a more summary fashion the accomplishments in the decentralization effort preceding 2005 and covered the FDSP accomplishments for the period 2004-2006. The identification of the people interviewed, the progress reports and other documents are provided in Appendix 2 of this report.

The evaluation was supported by 31 interviews conducted with the appropriate officials within the MEF, MOI, some provincial, district and commune level officials, representatives of the

donor community familiar with the project, and with UNDP and UNCDF staff involved in the operation and management of the project over this period.

An international consultant conducted the assessment, although the TOR had identified a team of experts to conduct the assessment. The consultant was assisted by the local national expert of the project as well as the staff from the Department of Local Finance in the MEF who assisted in the arrangements for the field visit to Siem Reap Province.

The evaluation is largely based on a subjective and judgmental assessment made from the conduct of the interviews, a review of the progress reports over the period 2005 through early 2007, a review of the papers and presentations developed by the consultants, and the training conducted either in country or at Duke University.

The project document initiating the project and the work plans subsequently developed did not identify specific performance standards by which the success of the project could be evaluated. There are work plan indicators but no indication of the performance standards that would be applied to the completion of these activities. Consequently, the evaluation has relied on the more subjective judgments that are based on the informed consensus of those that contributed to this evaluation.

Also, the financial reports do not relate the expenditure of funds to specific activities. The bulk of the funding provided by UNDP was for the Fiscal Decentralization Advisor and this is for a full time contract. The short-term consultants funded by UNCDF were also on a contract basis and their activities are related to specific requirements of a TOR. Consequently, there is no possibility of relating some economy or efficiency measures to the main activities of the project. It should also be noted that the financial information from UNCDF was in a line item expenditure basis and not provided on a summary basis for easy analysis. This financial information had not been previously made available to the Fiscal Decentralization Advisor or UNDP, although both had previously made requests for this information.

These are the major limitations on providing a more quantitative based assessment of the project achievements on an economy and efficiency of results basis.

The only person not interviewed or contacted for this report was the Decentralization Advisor in the MOI, Paddy Roone, who could have provided important information on the development of the Organic Law and the internal policy differences in the MOI that created the communication and coordination problems. Mr. Roone had left some time before this evaluation mission was undertaken.

Chapter 2 - Environment of Decentralization and Deconcentration (D & D) in Cambodia

This chapter addresses the broader situation with regard to the development of Decentralization and Deconcentration in Cambodia. It provides a description of the main policy level framework that has been developed over the past two years. Following this, the chapter addresses the organizational and institutional structures that are directed at designing and implementing the larger D & D and the specific organizations that are focused on the development of the fiscal decentralization system in Cambodia. It then identifies the main donor organizations and programs that are directed at supporting public finance management reforms and fiscal decentralization. And, finally, the challenges that face both the RGC and donor community in achieving a successful public finance management and fiscal decentralization system. An understanding of the situation, environment and challenges provides a basis for determining the relevance, impact and potential future programmatic options that should be considered by UNDP, UNCDF and cooperating donors to the UNDP and UNCDF for their current and future projects.

2.1 National D & D Strategic Framework (2005)

The major policy framework driving the present direction of progress on D & D was the issuance of the Strategic Framework on Decentralization and Deconcentration that was issued in June 2005. The report summarizing the FDSP highlighted the impact of the Strategic Framework document in the following quote: “This D & D policy framework radically shifted the scope of the decentralization-related reforms; broadening the potential scope of the reform to cover all levels of the public sector: national, provincial, district and Commune/Sangkat. Previously the scope was targeted to the Commune/Sangkat level, aimed at establishing a fiscal decentralization structure that would support this lowest level of elected local administration.”

The Inter-ministerial Committee (IMC) was established in June 2005 for the purpose of overseeing the formulation of the legal, political, administrative and fiscal structure that would be developed in the Organic Law. The IMC was to accomplish this by a process of dialoguing with the relevant stakeholders and develop the legal framework that would be placed into the submission of the Organic Law that would serve as the basis for a decentralized and deconcentrated system of government in Cambodia. Unfortunately, the IMC failed to open up the process and provide the opportunity for the dialoguing with stakeholders that was expected. The IMC did not hold any meetings and the process was driven by the internal MOI organizational structures.

This Strategic Framework redirection had a significant impact on the national level structures that were to implement decentralization as well as the focus and direction of the FDSP at that time.

A year later, the RCG established the National Committee to Support Decentralization and Deconcentration (NCDD). This organizational structure took on the responsibilities that had previously belongs to the National Committee to Support Communes, the Inter-ministerial Committee and the Seila Task Force. The functions of this NCDD are provided in the following box.

Article 3: NCDD has main missions as following:

- To continue functioning and take roles/responsibilities of NCSC and Inter-Ministerial committee for drafting Organic Law by integrating of these functions and roles/responsibilities to be under roles/responsibilities and authorities of NCDD.
- To study/research and implement a strategies and programs for transition, integration and phasing out of Seila program after ending of this program at the end of 2006.
- To develop and implement national initial-phase-program for democracy development at sub-national levels.
- To develop and approve an initial-phase-framework stated on components, timeframe and temporary activities of D&D reform for implementation during waiting period for promulgation of Organic Laws.
- To study/research, develop and provide recommendations to the RGC on establishment fund for D&D reform in order to mobilize resources from donors to support the needs of staffs and cooperation of NCDD, allocation for development and other necessary needs of sub-national levels as well as provision of technical assistances to concerned ministries.
- To study/research, review and provide recommendation to the RGC on the best options for mobilization of international fund for D&D reform.
- To study/research and prepare agreements between the RGC and donors on supporting of D&D reform in order to ensure that all donors are parties of these agreements that make sure the alignment of donor support.
- To ensure coordination and sufficient discussion between NCDD and ministries/institutions at central level in delegation of functions, powers and resources from central to sub-nation levels.
- To organize appropriate forums for the RGC and donors to coordinate cooperation and mobilization of resources to support D&D reform.

The NCDD has a much broader mandate than the former IMC and has been more open and participative in developing some drafts of the Organic Law. The 8 member NCDD is chaired by the Minister of Interior, with membership including the Minister of Economy and Finance (Deputy), Council of Administrative Reform (Deputy), and the Ministers of Rural Development, Planning, Woman's Affairs, and the Secretary of State Secretariat of Public Works and Secretary of State of the Ministry of Interior.

The second impact of the issuance of the Strategic Framework was to radically change the focus of the FDSP work plan to adapt to this new policy initiative. The original work plan, which had focused on the division of the assignments of the expenditures and revenues between the central and commune level and the piloting of these assignments, was restructured to include the provincial/district levels.

In addition, the scope of the capacity building effort had to be adjusted from an original focus on the Department of Local Finance to a broader support of the Ministry of Economy and Finance. The training and technical assistance was expanded to include other organizational structures, such as the Tax Department and the Economics and Finance Institute where training and technical assistance was provided in the coming months. On a policy level the FDSP adapted to looking at the revenue assignments with more specific support to the Tax Department to develop options on increasing own source revenues at the local level through introduction of possible property related taxes and other sources.

2.2 Organizational Situation for Fiscal Decentralization Development

The organizational situation for D & D and fiscal decentralization presents a rather different situation than in most transition countries. The first difference is that there are multiple structures dealing with D & D within the various ministries which have working groups formed to address some specific issues of the D & D. There are also a number of donor working groups that interact with these organizational structures.

Unlike other countries, the Ministry of Interior has played a very dominant role in the organizational structure through its support of the National Committee for Decentralization and Deconcentration (NCDD). In other countries, the Ministry of Finance often plays the lead or dominant role in either promoting or inhibiting the decentralization progress.¹

2.2.1 Ministry of Interior (MoI)

The Ministry of Interior has taken the lead role in supporting the development of the decentralization effort through its providing the Secretariat support for the NCDD, its control over the development of the Organic Law, and plays a major role in the operation and support of the Commune/Sangkat Fund at the provincial/district level to the communes.

Department of Local Administration

The Department of Local Administration within the Ministry of Interior is the main ministry department dealing with the development of the D & D efforts. As such, they give support to the NCDD as its secretariat, as well as receive the support from the UNDP PSDD project. The Department of Local Administration has mainly focused on the decentralization issues, while the General Department of Local Administration has focused on deconcentration.

Inter-ministerial Committee

As previously indicated, the Inter-ministerial Committee was organized in June 2005 to play a leading role in developing the Organic Law. However, it failed to provide the necessary leadership and openness in the process to develop a draft law that could be reviewed by the stakeholders.

There has also been great reluctance by the IMC to provide full and complete disclosure of the draft of the Organic Law, with only broad outlines of the Organic Law being provided. Interestingly, when the MEF asked for a copy of the draft Organic Law, the request was refused even though the MEF holds the Deputy Chairmanship of the NCDD.

Attempts to provide input to the drafting of the Organic Law relative to the fiscal decentralization aspects have not met with much recognition from the IMC. Drafts of a proposed sub-national system were prepared and submitted but there is no indication these were accepted into the draft Organic Law.

¹ The experience from the transition countries of Central and Eastern Europe indicates that the Ministry of Finance is the major opponent of decentralization due to the fiscal impacts of decentralization. The Ministry of Interior or other ministry charged with the development of the local governments is the main supporter of decentralization. In Cambodia, it appears that the MOI has effectively stalled D & D, while the MEF appears to be more supportive of fiscal decentralization.

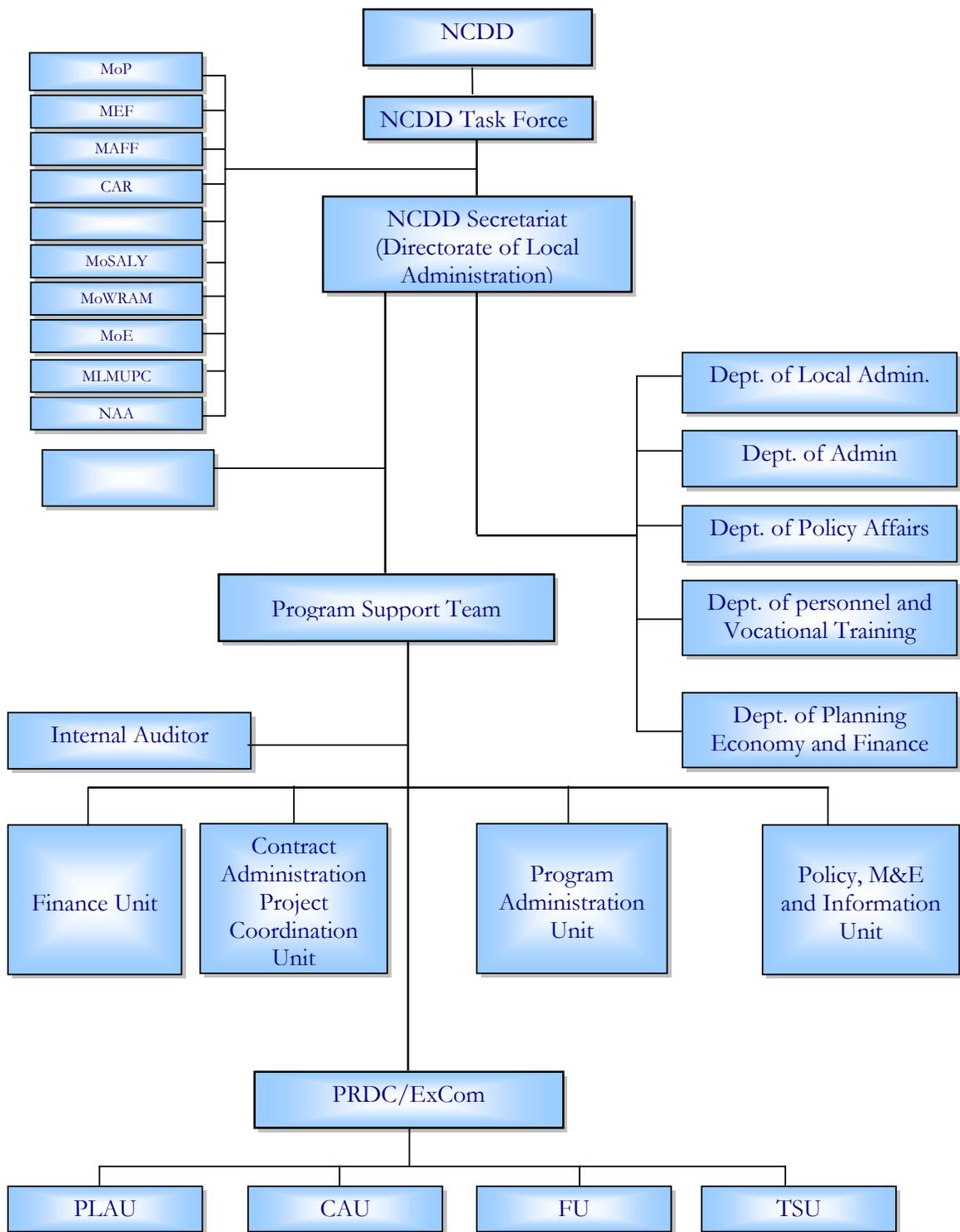
National Committee to Support the Decentralization and Deconcentration (NCDD)

In August 2006, the National Committee to Support the Decentralization and Deconcentration (NCDD) was established. It replaced the earlier Inter-ministerial Committee, the National Committee to Support the Communes (NCSC) and the Seila Task Force to provide one organizational structure to design, develop and implement the D & D Strategic Framework issued in 2005. It has an inter-ministerial membership as provided in Article 2 of the Decree as follows:

The composition of NCDD:

1. Minister of MoI Chairman
2. Minister of Office of the Council of Ministers Deputy
3. Minister of MEF Deputy
4. Minister of MRD Member
5. Minister of MoP Member
6. Minister of MWA Member
7. Secretary of State of Secretariat of Public Work Member
8. Secretary of State of MoI Permanent Member.

The organizational structure of the NCDD is presented in the diagram below.



In addition to this organizational structure, it was expected that the NCDD would establish additional subcommittees to develop mechanisms for dialogue and discussion of the many and complex issues of D & D. However, none of these have been created as expected and there is no appropriate financial subcommittee that the FDSP and MEF officials could interact with to develop the fiscal decentralization strategy based on the Strategic Framework and the drafting of the Organic Law. It appears that the development of the Organic Law is not a priority area within the MOI/NCDD apparatus as there are internal differences of opinion within the MOI senior levels on decentralization as an appropriate policy initiative for the Government. Until these differences are resolved, there would seem to be little possibility that much will develop with the Organic Law preparation.

2.2.2 Ministry of Economy and Finance (MEF)

The MEF was designated as the national partner for the FDSP project and within a National Execution (NEX) project implementation approach. The UNCDF was designated from the FDSP project document as the implementing agency responsible for the procurement of inputs and disbursement of funds under all budget lines in both the UNDP and UNCDF funded budgets.

Department of Local Finance (DLF)

The Department of Local Finance, created in 2003, was the original beneficiary of the support within the MEF for the inputs from the FDSP. The original mandate of the DLF was focused on support to the Commune/Sangkat Fund as its secretariat, the capacity of the communes to handle the financial management of the funds, and represent the MEF in areas dealing with decentralization reforms.

PFM D & D Working Group

The PFM D & D Working Group was established in 2005 headed by Chou Kimleng, the Deputy Secretary General of the MEF, and the National Program Director for the FDSP, to engage in broader development of the public financial management reform efforts. The membership was expanded in February 2006 to include all key departments of the MEF. The membership is composed of eleven members with meetings called as needed. The activity of the D & D Working Group was expected to meet regularly to provide input into the organic law process. However, due to the lack of activity arising from the delay in issuance of an Organic Law, which would be a major focus of the group activity, the PFM D&D Working group has tended to meet once every 2 months.

2.2.3 Development Partners

The Development Partners play an important role in influencing the central level structures and assistance that is provided through the donors in support of public financial management and fiscal decentralization.

The most comprehensive program to developing the public financial management reforms in Cambodia is through the RGC's Public Financial Management Reform Program (PFMRP) that began in December 2004. This is a highly structured program addressing all areas of improved public financial management and incorporates aspects of fiscal decentralization into its program activities. For this reason, a close level of cooperation and communication needs to be made with this project and the FDSP.

The donor community on a broad basis supports the PFRMP, with ten development partners contributing funding to the project through a Multi-Donor Trust Fund (MDTF) that is administered by the World Bank. The participating donors include AusAID, AsDB, DFID, EC, French Cooperation, IMF, JICA, SIDA, World Bank and UNDP. However, only four donors are contributing funds to the MDTF; these are WB, AusAID, EC and DFID. The other donors are invited to participate in the meetings to maintain coordination and communication across donors on their activities in the D & D area.

The support to the PFRMP is structured through Development Partner Committee and various subcommittees that interact with the Government Reform Committee Secretariat. The main governmental counterpart for this Development Partner Committee is the PFM Technical Working Group (PFMTWG). This is only one technical working group (TWG) among eighteen identified by the External Advisory Panel (EAP) report, but based on the assessment by the donor partners recorded in this report, the PFMTWG is one of the more effective technical working groups. One reason for this seems to be that the PFMTWG has representatives of the line ministries as well as the MEF and provides the opportunity for more involvement, information and inputs for those involved in the reform process. This seems to be in sharp contrast to the approach utilized by the NCDD that is dealing with the development of the Organic Law where little input from the line ministries and the MEF has been accepted.

There are other donor programs that are also supporting fiscal decentralization to some extent, but these are generally directed at support to the commune level through grants that are providing for infrastructure improvement. The PSDD project, supported by UNDP, DFID and SIDA, is one of the largest with support for infrastructure projects as well as capacity building support to the commune levels with organizational structures, systems, policy and infrastructure planning assistance. This project is operated through the Ministry of Interior, rather than with the Ministry of Economy and Finance.

A new initiative directed at supporting the District level is the UNDP, SIDA and DFID project called the District Initiative is supported through four different projects. These are:

1. Project one PSDD project supported by UNDP, DFID and Sida
2. Project two DDLG supported by UNDP and EU
3. Project three NRLM supported by DFID and DANIDA
4. Project four: ONE Window Service supported by WB, to support the capacity and integration of the District level administration on a pilot basis for possible replication on a larger basis in the next years. This would facilitate the development of the intermediate tier of administration that is missing as an important level of administration between the province and commune level.

2.3 Challenges to the Fiscal Decentralization Development

The TOR indicated the need for an examination of the current situation with regard to D & D in Cambodia and the challenges to successfully developing a more decentralized system of governance. In the following sections, the challenges that face the further development of D & D are presented as observations by the evaluator.

2.3.1 Creation of a Sub-national Democratic Development Program

The Strategic Framework that has developed the conceptual basis for implementing a D & D effort is still lacking a national program for D & D that would serve to guide the implementation

of the activities related to policy development and drafting of an Organic Law. There is consideration for developing this National Program for D & D in the coming months, but this may be inhibited by the lack of organizational structures that would push the development of the National Program as with the drafting of the Organic Law. The National Program, however, is not directly dependent on the development of the Organic Law. The National Program will likely be designed and certain aspects implemented prior to the enactment of the Organic Law.

The Implementing agency is expected to oversee the implementation on the OL, but it may not be established in the early stages of the implementation of the National Program.) There is some indication that a new Implementing Agency would be created as a replacement for the existing NCDD structure to accomplish this national program development.

2.3.2 Progress on the Organic Law

While there have been some national frameworks documents issued and organizational structures put into place, further progress on drafting the so-called Organic Law has not progressed over the past year. The drafting of this law has been confined to the IMC structure supported by the Ministry of Interior. Although this IMC is composed of membership from other ministries, including the MEF, the development of the draft has been closely held within the MOI with little information or development of dialogue either within the government or with outside stakeholders. The full draft has not been circulated and only small parts of it have been available. While there have been portions dealing with the fiscal decentralization and sub-national budget system drafted within the FDSP and provided to the advisors working with the IMC; there has not been an opportunity to fully review the whole Organic Law draft to determine if the fiscal decentralization proposal fit to the overall structure and responsibilities that would be defined for the national and sub-national units in the Organic Law.

Some effort needs to be made within the coming months to open this process for additional RGC ministries, national stakeholders in this process, such as the communes and NGOs, and the donor community to bring forth a national consensus on the provisions of the Organic Law and the future functions and structures of the D & D affected organizations.

2.3.3 National Level Coordination

There are numerous reform committees and other organization structures at the national level directed at supporting the D & D process. There is little indication that these have been well coordinated or have been effectively managed over the past several years. There is a need for a more coordinated and higher profile organization structure from the NCDD that has some capacity to coordinate across the ministerial organizations to effectively manage this effort. In some discussions with the MoI, there is an indication of a new Implementing Authority that would have such authority to coordinate and implement a national level program on D & D.

Even within the MEF there are numerous sub committees and working groups as identified in the EAP 2007 report (p.69). The report identified D & D Subcommittee, coordination groups on revenue, budget formulation, budget execution and policy, as well as working groups on budget integration, revenue policy and forecasting and budget law revision that would have some interest and input into the D & D national level processes.

The Donor Community has a working group on D & D as well as the NGO sector interests are represented with a similar working group.

2.3.4 Intermediate Tier of Government

One of the key policy issues in designing a decentralized system of government is how to align the sub-national structures to have sufficient financial resources to be an efficient and economical provider of services. There are certain services, such as transportation among others, that often require a large territorial and population size to be efficient. Often an intermediate tier of government, such as the district or provincial level, which has these capabilities, provides these services. This intermediate tier does not presently exist with sufficient capabilities and authorities under the present RCG structure to be capable of performing these functions. The Strategic Framework for D & D recognized this and made a major policy initiative to develop the provincial/district level as an intermediate tier that could provide services that are not capable of being delivered by the commune level. The exact functions and authorities of this intermediate tier is one of the major policy issues that need to be addressed. The donor community has recognized this with some programs, such as the District Initiative, that is focusing on developing this district level as a competent and effective deliverer of services.

2.3.5 Commune Capacity

With some 1,621 communes of varying sizes and populations, rural and urban, the capacity of these units to deliver services, with the limited human resources and financial capacity available to them, presents one of the most formidable challenges. There is a lack of professional staff as well as knowledgeable Commune Councilors that make decisions on commune level affairs. With the large number of communes and the resulting large number of commune councilors, this presents a formidable training and capacity building challenge to the communes. Most communes have only one commune clerk to handle the administrative and financial duties at this level. This situation is ameliorated to some extent through the Provincial Level support provided to the communes through the ExComm committees. The technical support is given to the communes to formulate their administrative and infrastructure plans and provide payment services through the Provincial Treasury.

2.3.6 Expenditure Assignments/Service Delivery

The communes, as the main level of local government, was only developed within the past years with the Commune Sangkat Administration Law and this only outlined in a very general manner the functions and authorities of this level. The Law does not specifically identify the services, such as education, health, water and sanitation that are normally provided to the lowest level of government to provide services. This is the expenditure assignment pillar of the fiscal decentralization process and this is particularly missing at this stage of D & D development in Cambodia. This is one of the main policy areas for analysis and study as the D & D process unfolds and the Organic Law is drafted.

2.3.7 Revenue Sources

There are very limited revenue sources available to the communes or lower levels of government, such as the provincial and district levels. The communes have only the possibility to charge for some services, such as for civil documents and certificates that can be issued at this level. The communes are dependent on funding that they can receive from the Commune/Sangkat Fund for the discretionary spending to fund their priority projects. However, this amounts to only \$8,500 per commune, on average, based on the formula utilized to allocate these funds. The communes do have other sources of funds, such as the Central Ministries and the Provincial Investment Fund, as well as the donors. The funds available to the communes, on average, are greater than the \$8,500 from the Commune/Sangkat Fund. The C/S funds can be used for local

administrative support, but the bulk of allocation must be used for infrastructure type projects according to the fund requirements. This greatly limits the possible projects, given the enormous needs at the commune level to finance the water, road and other improvements that are needed. The commune also utilizes the funds from the Provincial Investment Fund that are spent at the commune level on a project-by-project basis. So, the main source of funds is still the central level, as well as the donors who fund specific projects, to the communes. A priority area for development in the D & D process is to develop own-source revenues and other sources to the commune or higher level within a possible two-tier level of local authority structure that may be created in the future.

2.3.8 Use of Commercial Bank Accounts

The use of commercial bank accounts by the communes has been one of the main issues in the national level debate over the past several years. The donor community was divided on this issue, with most donors supporting commercial bank accounts, but the IMF opposing this. The IMF was mainly concerned about the control over the commercial bank accounts being held as individual account holders, rather than governmental organization. This opened up the possibility that the individual as the account holder would have access to the funds or control the funds even after they had possibly left their ministerial position. In the end the IMF position was adopted. However, this restriction has only applied to the use of central transfers from the national level, such as through the Commune/Sangkat fund or transfers from the ministries through the Provincial Treasury. Some donors that are supporting projects at the commune level are using the commune to open commercial bank accounts to make the payments under these projects. The donors are using the commercial bank accounts primarily through NGOs as well as to provide direct support to the communes. For example, a project may be initiated to benefit a commune, but the implementer of the project could be a local NGO and the funds will be transferred to the NGO to implement the project.

This issue is likely to continue into the future, but there is no clear indication that the policy will change. There is still pressure from the donor community, except for IMF, to allow the communes to have access to commercial bank accounts and to account for the transfers from the C/S Fund.

2.3.9 Transition from Platform 1 to Platform 2

The Public Financial Management Reform Program administered by the World Bank through the MDTF has developed a platform approach to improving the public financial management system. A recent External Advisory Panel assessment painted a mixed picture of whether the conditions had been met to transition to Platform 2 of the program. The report indicated that while some progress had been made the report stated “The EAP endorses the proposed strategy of preparing by 30 June 2007: (i) a detailed plan to implement key priorities to complete Platform 1 as expeditiously as possible and to ensure its sustainability, and (ii) at the same time a strategy for Platform 2” (p. 20). There are still numerous areas of the PFMRP where additional development is needed before the Platform 1 requirements will be met and the full-scale transition to Platform 2 can begin.

2.3.10 Provincial ExComm Unit Support to the Communes

The support provided to the communes in supporting the development and financing of local projects is critical to continuing to give some assistance to the communes for their needs. This support is provided through Provincial ExComm units that provide technical, procurement and payment support to the communes to implement their local projects. This capacity is presently

limited to the Provincial level, but the question is how to utilize this capacity and transfer it to the district or commune level in the future. The future of the ExComm as a provincial level service provider and the financial support needed to continue this support needs to be examined. The need to examine this provincial level of support arises through determining what level of deconcentration or decentralization will be developed for the governance system. If the emphasis is on decentralization, then the capabilities that are presently being concentrated at the provincial level would need to be transferred to the district or commune level. The present level of donor support to the Provincial level ExComm would need to be examined to determine if this can be phased out as the new provincial, district, and commune levels are given more financial resources to assume these responsibilities. The technical staffs of the ExComm are supported through the PSDD funded by the UNDP and other donors. This is an issue that needs to be examined as well as how to incorporate the systems, structures and procedures established through the ExComm into the future provincial, district and commune levels that will require these services.

2.3.11 Donor Channels to the Commune Levels

Some donors prefer to direct their support to specific communes and for specific purposes. This amounts to a large amount of funds that are outside the central budget process and transfer system of the Commune/Sangkat Fund. There is no overall national financial reporting system that captures these funds and their flows through the system. Given the large funding provided by WB, UNDP, and other donors, this is potentially a problem area that could affect the macroeconomic policies as well as the national budget decisions. This greatly complicates the introduction of a fiscal decentralization system as these sources and capacities cannot be calculated into the fiscal capacity and unmet needs that serve as a basis for central level grants and general-purpose transfers. While some progress has been made to incorporate the impact of the donor funding into the financial reporting, there are still substantial amounts of funds that are not accounted for. There is a need to further identify and account for these funds and to incorporate this into the factoring of the design of the fiscal decentralization policies and procedures in a more comprehensive central level budget and priority setting process.

2.3.12 Consolidation of the Non-budgetary Funds Not Available Through Existing Systems

There is still a major challenge in providing a comprehensive budget that reflects the sources of revenues from the central as well as donor sources. This appears to be a particular problem with regard to the inclusion and identification of the off budget revenue sources. The basis for this assessment is revealed in the 2007 External Advisory Panel (EAP) Report prepared for the Public Financial Management Reform Programme, implemented as part of the Multi-Donor Trust Fund (MDTF). The EAP report prepared by the External Advisory Panel stated the following “Little progress is evident in identifying and incorporating other revenue sources, including non-tax revenue, that are outside the budget. Therefore, it is not possible to conclude that the budget is fully comprehensive, in the absence of better information on non-tax revenues collected by the ministries and institutions” (p. 8). The report goes on to indicate that the ministries have not been cooperative in improving this situation as these funds are used for ministry purposes and the MEF has not been able to get the necessary information on these revenue sources. (p. 28)

2.4 Observations and Lessons Learned

This section has addressed some of the environmental issues, particularly the organizational and policy areas, that frame the context in which decentralization is being implemented in Cambodia. In this closing section, a summary of the observations as well as lessons learned that might be applied in future decentralization programming is elaborated.

The environmental context is rather complicated in Cambodia. The decentralization effort has not gone beyond a conceptual stage with little progress toward developing a full functioning legal framework for implementing decentralization and deconcentration. There are several factors that appear to lead to this situation.

First, implementing decentralization is a complex process in the best of circumstances. One of the key factors that enhance the chances for implementing decentralization is the development of the political will and that the issue and the process have a champion within the governmental structures. This political will and champion of decentralization ideally needs to be at a level above the ministerial level, but in some cases a ministry, particularly the Ministry of Finance, can be an important champion of this process. This appears not to be the case in Cambodia. There is little evidence based on an analysis of the progress toward the drafting of the Organic Law, the activity of the NCDD, the lack of additional subcommittees being formed, and the failure to have decentralization as an issue on the agenda of the government, that a champion of the decentralization issue has been taken on at levels of government sufficient to have an impact. It seems that the action is still taken at sub-ministerial levels, with little intervention or interest from above.

Added to this complexity is the multitude of organizational working groups, technical committees and others that seem to be directed at solving technical issues while the larger policy issues are neglected.

There are still many challenges to implementing decentralization that have been identified in the section above. These challenges are not addressed in any coherent policy framework or work program that is being implemented or coordinated across the government or provides an opportunity for outside stakeholders, such as the commune associations or civil society organizations, to play a role in the development of D & D.

This observation on the lack of a political will and champion for decentralization has led several observers to comment that decentralization is stalled and little progress will be made in the policy areas in the coming year. This is indicated in the EAP report. There is also the impact of the election cycle that will come into play in the next year.

The lesson to be drawn from this is that decentralization has to be supported by the political will at the highest levels and has to be part of the larger governmental agenda and reform program. If this does not occur the possibility for much progress to achieving a decentralized system will be difficult, if not impossible.

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2.3.2	Some effort needs to be made within the coming months to open this process for additional RGC ministries, national stakeholders in this process, such as the communes and NGOs, and the donor community to bring forth a national consensus on the provisions of the Organic Law and the future functions and structures of the D & D affected organizations.
2.3.3	There is a need for a more coordinated and higher profile organization structure from the NCDD that has some capacity to coordinate across the ministerial organizations to effectively manage this effort.
2.3.7	A priority area for development in the D & D process is to develop own-source revenues and other sources to the commune or higher level within a possible two-tier level of local authority structure that may be created in the future.
2.3.10	The future of the ExComm as a provincial level service provider and the

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	financial support needed to continue this support needs to be examined
2.3.11	There is a need to further identify and account for these funds and to incorporate this into the factoring of the design of the fiscal decentralization policies and procedures in a more comprehensive central level budget and priority setting process.
2.4	The lesson to be drawn from this is that decentralization has to be supported by the political will at the highest levels and has to be part of the larger governmental agenda and reform program. If this does not occur the possibility for much progress to achieving a decentralized system will be difficult, if not impossible.

Chapter 3 - Evaluation of the FDSP

3.1 Evaluation of Results of FDSP

This chapter examines the evaluation of the FDSP from the perspective of its support to the technical components of the project, rather than the program management functions that will be examined in a later chapter. The assessment here will first examine the accomplishment of the work plan components in the initial review for the period through 2006 and then for the period in 2007. Particular emphasis will be placed on those aspects of the 2007 work plan components that will be impacted, based on the funding available and the need to provide further support following the departure of the Fiscal Decentralization Advisor in June 2007.

Following this review of the components of the FDSP, there will be a further assessment of how the project has impacted on certain policy level areas as well as the capacity building aspects of the project on particular MEF organizations. This is intended to give a crosscutting evaluation of the overall technical and training assistance aspects of the project.

3.1.1 Factors Affecting the Completion of the Project Activities

There were a number of factors that impacted the activities of the project and their implementation. These are factors external and internal to the project.

Several external factors affecting the timing and activities of the project should be taken into consideration as the assessment of the project is undertaken. These factors, in some cases, determined whether the work plan activity could be fully, partially, or not achieved. Those activities that were significantly affected by these factors are identified in the evaluation comments incorporated into the component table in the text below.

The first external factor was the previously indicated changes to the overall D & D situation as a result of the new Strategic Framework. These have been identified earlier in terms of how it changed the focus of the project and, subsequently, the work plan activities. This changed the focus of the project design and work plan activities away from a commune focused project dealing with the C/S fund and service delivery to a more policy development project focused on supporting the drafting of the legal framework in the Organic Law, the identification of expenditure and revenue assignments, and the development of a two-tier system of local authorities with changes at the provincial and district level.

A second factor was the impact of the drafting of the Organic Law, which was conducted in a very unusual manner. Many of the activities related to the drafting of a decentralization strategy and other policy inputs were affected by the way in which the drafting of the Organic Law was confined to the IMC and with MoI, without the possibility of having an opportunity to work from a draft document. Several activities of the components, particularly component 2, were dependent on being able to provide inputs into the drafting of the Organic Law, which was the responsibility of the IMC at the earliest stages. The difficulties encountered in maintaining liaison with the MOI proved to be more difficult. The manner in which the drafting of the provisions of the Organic Law was held within the confines of the MOI proved an obstacle to accomplishing the development of the FD strategy and other policy related documents.

A third factor was that the subcommittee structure of the NCDD, which is expected to include a financial subcommittee, was never created and, therefore, there was no real inter-ministerial

organizational focus for providing the policy input on fiscal decentralization. The FDSP policy inputs for discussions were therefore limited to within the Ministry of Economy and Finance

Despite these difficulties, the project did provide inputs and comments on the design of a fiscal decentralization policy, the requirements for a sub-national financial system and other policy related advice and support as appropriate. The overall impact of this cannot be assessed as there is still no draft to compare what influence these policy input might have had.

An additional factor that affected some activities relating to the operation and implementation of the Commune/Sangkat fund must also be addressed. It was expected that a Commune/Sangkat Board that would oversee the operation of the fund would be created. This did not occur despite repeated attempts to do this. The project provided additional input in the design of a Fiscal and Financial Decentralization Committee that would have a broader mandate over a whole intergovernmental fiscal transfer system. This is still a possibility as the future development of the Commune/Sangkat Fund is reviewed.

Also, the activity of supporting the commune's financial management by having the Commune/Sangkat Funds administered through commercial bank accounts, rather than through the provincial treasury, was rejected by the government largely based on the advice of the IMF on this issue. So, this activity of the Commune/Sangkat Fund could not be tested or realized.

A service delivery study effort was partially fulfilled, but was halted following the development of a report and conference on the issue. It was felt that testing some service delivery approaches would pre-empt the assignment of functions that was to be determined during the deliberations on the Organic Law and it was felt that any such activity should be halted until the Organic Law was issued.

There were a couple of internal project management factors that also affected the implementation of the project. There was some delay in getting the project started due to not finding a long term resident Fiscal Decentralization Advisor. At least two persons served briefly in this capacity prior to the recruitment of Dr Roy Kelly who arrived in August 2005. While this delay may have affected some initial activity, the development of the modified work plan based on the new Strategic Framework for D & D was effectively accomplished during the early weeks of Dr Kelly's time as the resident advisor.

The UNCDF actions as the implementing agency may have been impacted by not have a physical presence in Cambodia during the early stages of the project. This may have delayed recruiting local staff and making other arrangements, which was effectively performed by UNDP, although this was not specifically UNDP's responsibility.

These internal project factors were effectively overcome following the arrival of Dr Kelly and the project picked up momentum as a result of this.

3.1.2 Review of Project Documents

The basis for making this technical assessment of the FDSP accomplishments rests on review of the project documents, work plans, progress reports and the training materials and presentations that were prepared over the course of the project activities in these years. A description of the technical papers and presentations prepared by the consultants is provided as Appendix 3 to this report. These documents were found to be very detailed and informative and combined with the interviews that were conducted with the MEF organizations and donors, the assessment of the FDSP during this period has been thoroughly examined.

Another source that was used was a UNCDF Mission Report, prepared by Dr Paul Smoke in November 2006, that provided a very comprehensive overview of the accomplishments of the project on the component basis and his comments are incorporated into the appropriate sections.

Dr Roy Kelly, the Fiscal Decentralization Advisor, provided even more detail on the component activities beginning from 2001 to 2006, and a complete assessment of the FDSP within the broader DSP. This document is referenced in the annex to this report and is recommended to the reader for more specifics on the FDSP over these years.

3.1.3 Completion of Work Plans 2005-2006

Based on the review of the project objectives following the issuance of the National Strategy for Decentralization and Deconcentration in June 2005, the following three components were identified for incorporation into the work plan for 2006. These components are:

1. Improved MEF Capacity in Intergovernmental Fiscal Policies
2. Fiscal Decentralization Strategy Developed
3. Improved Legal Framework and Procedures for Sub-national Financial Systems and Procedures.

The following examines each of the components and the related activities with intent to determine what was accomplished during the work plan period. The review is limited to the 2006 work plan as this is the first work plan year following the revision of the original work plan, due to the changes that resulted from the Strategic Framework dramatically altering the focus on decentralization to the provincial/district level and making the D & D a broader effort for reform.

Component 1: Improved MEF Capacity in Intergovernmental Fiscal Policies

The accomplishments toward improving the MEF capacity in this area have been successful from the 2005 initiation of this component. Many of the activities identified below have been accomplished and have achieved some significant impacts on the capacity of the staff of the MEF, particularly the Department of Local Finance.

One of the key results of this component is the expansion of the membership of the MEF D & D Working Group. From three departments represented at the very beginning, the Working Group was expanded to include the eleven major departments of the MEF. Important additions to this membership was the inclusion of the following: Department of Local Finance, Department of the Budget, Department of Taxation, Department of Investment and Cooperation, Department of Economic Policy and Public Finance, and the Treasury. The D & D Working Group provides a forum to discuss issues, prepare papers and presentations as a means of developing further the knowledge, skills and ability of the MEF staff in the fiscal decentralization policies. The Working Group has provided the broader forum for the transfer of knowledge and skills concerning the fiscal decentralization issues and a sounding board for the policy proposals that have been submitted to the draft of the Organic Law.

This component was further developed through the conduct of training sessions, both within the Department of Local Finance on a regular weekly basis, as well as formalized course at the Economics and Finance Institute on Fiscal Decentralization. These training efforts, accompanied by the use of field visits to the province, district and communes, have greatly added to the capacity of the MEF to develop practical solutions to the existing problems in the C/S Fund

transfers to the provincial level. These solutions include changes to the timing of the information to the communes on the amount of funds to be provided from the C/S Fund. The examination of the flow of funds from the central to the provincial treasury that is being undertaken will produce a more predictable payment system for the communes' projects.

Those activities related to development of coordination and communication with the MOI has not achieved as much success as had been hoped, despite a concerted effort by the Fiscal Decentralization Advisor to develop these linkages. This is the only major failure of this component. It should be clarified here that some of the responsibility for this must be shared with the Decentralization Advisor that was funded by UNDP in the MOI. This adviser played a key role in the drafting of the Organic Law and was the main point of contact by the Fiscal Decentralization Advisor for this effort. Also, contributing to this situation was the internal policy differences within the senior levels of MOI on whether to pursue decentralization as a national level policy in Cambodia.

The FDSP project does show some considerable impact on the policy direction within the DOLF and its activities. The policy level directions are mainly demonstrated through the policy papers on sub-national budgeting, the improvements in the flow of funds through the C/S Fund, as well as the increases in the commune allocations from the national revenues that will begin in 2008 through 2010.

Overall, it is judged that this component has achieved substantial success in achieving the activities and the results that were expected. Importantly, the work with the Tax Department and EFI on capacity building through training sessions has added even more value to this component success than was originally conceived in the project document and work plan for 2005-2006. Of the 9 activities identified in Component 1, 7 are judged to have been fully achieved, 1 partially achieved, and 1 not achieved.

Following the Component 1 activities in the box below, there is provided the assessment of Component 1 from the mission report prepared by Paul Smoke in November 2006. This assessment above is in general agreement with the conclusion reached by this UNCDF consultant, Paul Smoke, to the project. Evaluation comments on each of the activities are provided in the text below in bold.

Intended Outputs	FDSP 2006 Work Plan Indicative Activities	
1. MEF Capacity on Intergovernmental Fiscal Reforms		
1. Improved MEF capacity in intergovernmental fiscal policies	Activate MEF D&D working group on issues of Intergovernmental Fiscal Policies.	Activate PFM D&D Working Group within MEF to serve as the consultative forum for discussing decentralization and intergovernmental fiscal issues. Members can be expanded as needed. Evaluation Comment: This was successfully achieved by expansion of the D & D Working Group to 11 members covering all major departments of the MEF.

Intended Outputs	FDSP 2006 Work Plan Indicative Activities	
1. MEF Capacity on Intergovernmental Fiscal Reforms		
	Capacity Development will be provided to the MEF Working Group members on issues of fiscal decentralization.	Two D&D Working Group members per year will be sent to international courses/programs on issues of fiscal decentralization and local government finance. Evaluation Comments: This was accomplished in 2006 and 2007 by sending the WG members to the Duke University course on FD.
2. Developed DOLF structure, functions and capacity	Define functions of DLF as possible PFM D&D Working Group Secretariat.	In parallel with activation of the PFM D&D Working Group, identify roles and responsibilities for the DLF as WG secretariat. Evaluation Comments: This was achieved on an ongoing basis as the work of the DLF was developed over the course of the project.
	Define training needs and training materials.	Based on the DLF structure and responsibilities, a training plan should be developed. Evaluation Comments: A training assessment was made and the training on weekly basis was initiated by the Fiscal Decentralization Advisor in addition to more formal training sessions provided to the DLF staff.
	Provide training to DLF staff.	Training (both on-the-job and formalized training) should be provided to the DLF staff. Evaluation Comments: This was successfully achieved through the formal training and with the conduct of field visits to reinforce the training provided.
	Develop structure of DLF Local Finances Unit and JD of all posts.	Define DLF structure along with official job descriptions for all posts within the Department. Evaluation Comments: Not achieved during this period of review

Intended Outputs	FDSP 2006 Work Plan Indicative Activities	
1. MEF Capacity on Intergovernmental Fiscal Reforms		
3. Strengthened DOLF/MEF linkages across stakeholders on FD/D & D	Liaise with other MEF departments.	Maintain liaison with MEF departments through the PFM D&D Working Group, among others. Evaluation Comments: This was effectively accomplished with activation of the broader D & D Working Group and regular meetings and trainings were held
	Liaise with Ministry of Interior and other government agencies.	Maintain liaison with Ministry of Interior on issues related to fiscal decentralization and D&D. Evaluation Comments: Limited achievement of this activity due to difficulties in the MOI and the operation of the NCDD not being fully developed and implemented
	Liaise with Development Partners on issues of FD and D&D.	Maintain liaison with development partners on issues related to PFM and D&D. Evaluation Comment: Effectively achieved through contacts with the D & D Donor Group, D & D NGO group, and with relevant international organizations including WB, IMF, DFID, DANIDA, SIDA, among others
<p>NOTE: Substantial progress has been made on capacity building related to fiscal decentralization within MEF. Substantial development of DOLF has been moved slowly given the changes in MEF internal structures and responsibilities that are likely to emerge as the Organic Law is released. In this regard, for example, some functions that were originally intended for DOLF may be more appropriately placed in the Department of Budget or the Department of Taxation. Some good progress has been made on linkages with development partners, but progress has been more limited in bridging MEF and other agencies in the complex institutional environment that has existed during 2006.</p> <p>Source: Paul Smoke Mission Report, November 2006</p>		

Component 2: Fiscal Decentralization Strategy

Component 2 has rather mixed results and no real impacts can be discerned from the activities that have been undertaken in this component. The activities mainly relating to development of policy input documents, such as policy option papers and presentations to the D & D Working Group have been accomplished. These do provide a basis for indicating that there is some basis for future consideration of these policy recommendations if the reform effort is energized in the coming months or years. However, many of these policy recommendations and strategies may be drastically modified once a National D & D program is developed and a draft Organic Law is presented for more open debate and discussion.

The interaction with the MOI was a particular problem as it relied on a cooperative effort that was not forthcoming. The difficulty of interacting with the IMC and obtaining pieces of the draft of the Organic Law as well as the lack of the creation of the Financial Subcommittee in the new NCDD structure has prevented some progress in this area.”

Overall, the component achieved less than expected in terms of its impact on the development of a fiscal decentralization strategy, but the circumstances creating this were to a large extent outside the influence of the FDSP team. Of the 9 activities identified in this component, three are considered to be fully achieved, three are partially achieved, and three have not been achieved.

2. Fiscal Decentralization Strategy		
Articulated fiscal decentralization strategy incorporating D&D and public financial Reforms	Interact with MOI and other stakeholders on intergovernmental fiscal policy aspects of the Organic Law.	Working with MEF D&D WG, liaise with MOI on drafting fiscal decentralization components of the Organic Law. Evaluation Comments: Liaison with MOI/NCDD structure was not fully achieved largely due to the internal situation with MOI and the failure of the NCDD to create the necessary organizational subcommittees
	Prepare draft policy issue presentations on key intergovernmental fiscal issues.	Prepare draft policy presentations on issues such as revenue allocation, intergovernmental transfers, expenditure allocation and service delivery, budgeting, financial management, local borrowing, local capacity development. Evaluation Comments: This activity was achieved to the extent that the work on service delivery and revenue options could be developed in research papers, however, national level policy decision postponed further work until the Organic Law was developed

2. Fiscal Decentralization Strategy		
	Present policy options to the MEF D&D Working Group.	Hold Policy Seminars with the working group to discuss these policy options and to develop and refine policy alternatives. Evaluation Comment: Policy seminars were held on tax and revenue options, and the policy options were incorporated into the FD course.
	Consolidate draft policy options into consistent fiscal decentralization policy framework.	Prepare draft Fiscal Decentralization Paper to support the D&D strategy and the public financial reforms. Evaluation Comment: While some work has been accomplished on this activity, the final development of a FD paper is postponed until the provisions of the Organic Law are known and can be incorporated into the FD paper. A copy of the developed paper was presented to the Organic Law Drafting Team for their consideration in developing the Organic Law, but there is no indication these were adopted.
	Prepare draft fiscal decentralization framework.	Consolidate FD draft options and feedback from MEF D&D WG to prepare draft FD policy framework. Evaluation Comment: The draft options were presented to the D & D WG as well as other stakeholders, including WB, UNCDF, and UNDP.
	Assist in the formulation of the D&D Reform Implementation Strategy.	Assist in formulation of the NDDP. This work will commence following independent study. Evaluation Comment: This has not begun pending development of the NCDD activity on developing the National Program.
	Prepare draft fiscal decentralization implementation strategy.	Based on the D&D strategy, the Organic Law and the MEF policy position papers, prepare a draft fiscal decentralization strategy. Evaluation Comment: A draft implementation schedule for FD was developed and presented to the PFM Working Group and the Organic Law Team.

2. Fiscal Decentralization Strategy		
	Assist MEF in organizing a FD Strategy Development Workshop.	Assist in a workshop should be held to discuss the FD strategy with relevant stakeholders. Evaluation Comment: A seminar has been planned, but not yet held due to insufficient knowledge on the details of the Organic law and the implications for FD.
	Develop draft FD implementation strategy support.	Assist in development of FD implementation strategy support framework to mobilize necessary political, financial, institutional support for sustained implementation. Evaluation Comment: This activity has not been developed due to delays in having a draft Organic Law available to support this activity.

The assessment of this component from the mission report of Paul Smoke in November 2006 is shown in the following box.

NOTE: Considerable progress has been made on the articulation of fiscal decentralization issues and options and in generating discussions within the MEF D&D Working Group. It has, however, been much more difficult to move forward substantially with a formal draft fiscal decentralization policy and implementation strategy given the absence of direction on the larger institutional structures from the pending D&D Organic Law.

Source: Paul Smoke Mission Report, November 2006.

Component 3: Improved Legal Framework and Procedures for Sub-national Financial Systems

Component 3 has achieved substantial impact and success in three of the four areas identified in the work plan. These will be more fully discussed in the following paragraphs.

The improvement of the C/S Fund flows has been an area of particular activity and there is some good progress in clarifying the problems and providing some solutions to the delay in making the transfers to the provincial treasuries and final payments for the completed commune projects. This activity has particularly benefited from the use of the field visits to get current information from the local authorities on these problems. There is also an improvement in the timing of the estimations of the funds available to the communes as a result of the fieldwork and visits to the communes. The communes were not able to know until early in the fiscal year the amount of funds they would receive and, thus, making it difficult to do their local planning and know what their financial resources would be. Based on the recognizing this as a problem area, the FDSP formulated a new basis for estimating the national revenue and the amounts that would be available to the communes prior to the beginning of the fiscal year. These estimations were made known to the communes so that they could more adequately plan their local projects. The technical assistance provided by the FDSP to the MEF DOLF can take substantial credit for these improvements.

“The improvement of the commune council financial resources through possible introduction and implementation of a property tax has begun with the development of studies and presentations to the Tax Department. While there is good interest and commitment to the possible introduction and implementation of a property tax, the continuation of this activity will be affected by the forthcoming election cycle. However, other efforts to assess own source revenues, administrative fees and user charges will be continued in 2007. Therefore, this activity shows some potential and the whole policy area of revenue mobilization should be a priority area for further project support even beyond the end of the FDSP.”

The activity relating to the development of service delivery had some initial early success with the accomplishment of a very comprehensive and well developed report on service delivery developed by the Cambodia Development Research Institute (CDRI). A conference was planned with high-level visibility to promote and disseminate the results of this study. The conference was held but with much less promotion and visibility than had been expected. The activity was to continue to a ‘piloting’ of service delivery, but this was foreclosed based on the consideration that such an activity might ‘pre-empt’ the policy discussions that would be a part of the development of the Organic Law.

This activity was basically put on hold following the conference in February 2006 pending the development of the Organic Law and the possibility to further engage in pilot projects dealing with service delivery at the commune levels.

Activities four and five of this component have achieved more success in promoting the changes to the financial management system. The continued work of the UNCDF consultant, Mohamed El-Mensi, on these issues has resulted in reports and papers that provide a solid basis for further developments in these areas. These have recently been completed and further efforts in this area will be continued during the remained of 2007.

In summary, with the exception of the service delivery area, this component has achieved the activities and continues to provide good input and impacts on the operational aspects of the sub-

national financial system. Of the 18 activities identified for this component, nine are judged to have been fully achieved and nine not achieved.

The assessment by Paul Smoke concerning this component is provided in the box following the Component 3 work plan activities.

3. Improved Legal Framework and Procedures for Sub-national Financial Systems		
1. Improved operations of the Commune/Sangkat Fund	Assist regularize flow of C/S Fund flow	
	Review C/S Fund flows.	Review CS fund flow mechanism and experience. Work with DLF officials to evaluate fund flow, identifying constraints and recommending improvements. Conduct field visits with DLF as part of capacity building and analysis. Evaluation Comments: This has been a major effort of the FDSP and the DLF staff. It has been effectively implemented with analysis of the flow of funds, improvements in the timing of the commune revenue estimates, and the increase in the allocations to the commune from the C/S Fund.
2. Increased commune councils financial resources	Assessing own source revenue options	
	Review commune level contribution experience.	During field visits with DLF officials, evaluate role of contributions n local level finance. Identify options for further reform. Evaluation Comments: The field visits have produced valuable information on the use of funds at the local level. There is further effort to improve the financial database that provides additional information on the use of funds at the commune level.
	Assess feasibility of property tax/community service levy.	An analysis of the property tax/CSL will be carried out, leading to the preliminary design of the new revenue instrument. Evaluation Comments: This has been successfully completed with publication of paper on property tax implementation in Cambodia by Rubi Sagana.
	Develop policy and operational procedures for the property tax/CSL.	Develop the policy and operational procedures for PT/CSL. Evaluation Comments: This is yet to be accomplished pending further development of decision on whether to pursue property related taxes in advance of forthcoming elections.

3. Improved Legal Framework and Procedures for Sub-national Financial Systems		
	Identify demonstration areas for implementation.	Choose pilot site for demonstration exercise. Evaluation Comment: This activity is pending developments at the national level and the impact of the forthcoming elections on this.
	Training and dissemination.	Develop training materials and train related demonstration personnel. Evaluation Comment: On hold pending further developments.
	Implement the demonstration.	Assist MEF carry out the demonstration exercise. Evaluation Comment: On hold pending further developments.
	Evaluate demonstration.	Evaluate the demonstration exercise. Evaluation Comment: On hold pending further developments.
	Develop draft PT/CSL implementation plan.	Develop PT/CSL roll out plan. Evaluation Comment: On hold pending further developments.
3. Commune councils local development responsibilities are better defined	Pilot decentralized service delivery	
	Review the 2005 service delivery study.	The CDRI study on service delivery options to be reviewed. Evaluation Comment: This study was completed.
	Technical workshop on service delivery options.	Hold technical workshop to discuss the SD study with relevant stakeholders to develop a mutual commitment to design, evaluate and learn from a pilot "decentralized service delivery DSD" project. Evaluation Comment: A technical workshop was held but at a level less than expected due to national level policy not to pursue this issue pending the development of the Organic Law.

3. Improved Legal Framework and Procedures for Sub-national Financial Systems		
	Participate in the formulation of the expenditure assignment issues related to the Organic Law.	Participate in Organic Law formulation. Evaluation Comment: This was accomplished as part of the overall effort to provide input into the Organic Law. The assignment functions were defined as part of the contribution to the Organic Law Drafting Team.
	Conduct further research on SD “unbundling” exercise in key services.	Working with MRD, Health and Education, further analyze SD activities and functions to assist in assigning functions across levels of government. Evaluation Comment: This was not pursued as the effort on SD was halted following the holding of the SD technical workshop.
	Design a C/S service delivery pilot.	Based on study and national workshop, a C/S SD pilot should be designed. Evaluation Comment: This was not accomplished as the effort on SF was halted following the holding of the SD technical workshop and development of the Organic Law.
4. The C/S financial management system is refined	Develop C/S assets management regulations	
	Review regulations on assets management.	Prepare draft CS asset management regulations to be reviewed by MEF. Evaluation Comment: There is no indication that this was accomplished.
	Review C/S Finance Management System	
	Review the C/S M&E system.	Review CDAS (Cambodian Decentralization Accounting System) and recommend way forward. Evaluation Comment: This was accomplished as part of the missions of Mohamed El Mensi on formulating the financial systems at the provincial, district and commune level.

3. Improved Legal Framework and Procedures for Sub-national Financial Systems

5. Developed legal regulations for provinces and districts financial management systems consistent with D&D-related Organic Law	Review existing provincial and district financial management regulations and procedures.	Based on the D&D framework and the proposed Organic Law on D&D, undertake a review of provincial and district financial management regulations/procedures. Evaluation Comment: This was accomplished during the missions of Mohamed El Mensi and details provided in the mission reports reviewed for this evaluation.
	Develop draft provincial and district financial management regulations and procedures.	Draft provincial and district financial management regulations and procedures. Evaluation Comments: The procedures have been incorporated into the mission reports of Mohamed El Mensi.

NOTE: Limited progress has been made on the local revenue side given the uncertainty in future intergovernmental fiscal structures and responsibilities and how these will relate to larger fiscal and financial reforms being planned under the Public Financial Management (PFM) Reform Program. More progress has been made on studying and discussing initial service delivery issues and the drafting of possible improvements to the financial management system. But again, most of the work in these areas ultimately needs to follow the direction of the pending Organic Law regarding broader intergovernmental structures. As the law may be further delayed, some limited piloting of possible reforms seems the most likely option for next steps in 2007 (see Annex 3).

Source: Paul Smoke Mission Report, November 2006.

3.1.4 Work Plan For 2007

The FDSP has formulated a work plan for the continuation of the project activities through the end of 2007 based on presently available funds. Though the funding and participation of UNDP will end in mid-year, the UNCDF still has plans and unused project funds available to continue to provide support under the project through December. The intention is to continue these activities and in the interim develop a new project document that will carry the project forward beyond 2007.

The review of the work plan for 2007 indicated a full range of activities in each of the three components of the existing project. Some of these have already been completed, some have been started and others are scheduled for later in the year. The work plan was compared to the UNCDF budget projection for the rest of the year to ensure that the resources are available to provide the short-term consulting support that is required to complete the activities. Based on this review, the UNCDF should be able to provide the resources to complete the activities identified in the work plan.

The work plan will continue the capacity building efforts with the Department of Local Finance through training and support for conducting budget analysis, data collection of financial information from the commune levels and the disaggregation of this data to facilitate this analysis. Continuing the field visits by the Department of Local Finance staff and the support of the FDSP national level staff will develop this capacity. The staffs are already well trained in

doing this work and there does not appear to be any obstacle to continuing and completing this activity.

There will also be a continuation of the effort to improve the flow of funds to the commune through analysis and investigation of the process of releasing these funds from the treasury to the provincial level. Bottlenecks are apparent in this effort and the analysis of the flow of funds may indicate where changes in procedures may improve the situation where the funds are more readily available for payment to those contractors that have completed their projects and are due payments.

A further strong effort during the remainder of the year will be to develop the policy analysis on local government own source revenues, including defining administrative fees and user charges and other options that should be explored to improve the sub-national finance capabilities.

The only major activities that are either on hold or may not be completed are those that involve working with the MoI/NCDD on policy level issues due to the failure of the NCDD to establish a financial subcommittee as the focus and organizational entity to address these issues. Overall, this is a small portion of the activities planned and should not materially compromise the other activities that are scheduled in the 2007 work plan.

The activities that will not be completed by end of August are the following:

1. Design and implement capacity development workshops for NCDD and NCDD Subcommittee on FD issues due to the fact these subcommittees have not been formed.
2. Assist in facilitating discussions on the draft MEF FD strategy document within the NCDD structure due to the fact that these structures have not been put into place.
3. Work with MEF/NCDD to develop and evaluate options for CSF oversight and policy until eventual development of a broader intergovernmental fiscal policy management system due to the NCDD not creating the subcommittee structures to deal with this issue
4. Work with NCDD/MEF to explore options for introducing a broader central-local transfer mechanism to include all sub-national levels since NCDD has not created the organizational subcommittees to deal with this issue.
5. Work with NCDD/MEF to develop options for piloting improved sub-national planning, budgeting and implementation options to provide efficient and accountable service delivery due to NCDD not creating organizational subcommittees to deal with this issue.

Of the 18 activities identified for the 2007 Work Plan, 13 are either fully achieved or will be achieved in the remainder of the year by continuation of UNCDF consultant support, while five have not been achieved pending due to problems of coordination with the MOI/NCDD structures that have put some of these activities on hold.

Fiscal Decentralization Components (2007)

Intended Outputs	Indicative Activities		2007			
			Q1	Q2	Q3	Q4
RGC capacity on Fiscal Decentralization			Q1	Q2	Q3	Q4
1. Improved NCDD/MEF capacity in fiscal decentralization fiscal policies	Strengthen NCDD and NCDD Subcommittee on Finance on issues of FD policies.	Design and implement capacity development workshops for NCDD and NCDD Subcommittee on FD issues. Evaluation Comments: This has not been accomplished due to NCDD not creating the subcommittee to deal with these issues.		x	x	X
	Strengthen PFM D&D working group capacity on issues of fiscal decentralization policies.	Design and implement capacity development workshops and discussions for MEF Working Group on FD issues. Evaluation Comment: This is an ongoing activity with the development of weekly training sessions and more formal training sessions on FD.	x	x	x	X
2. Strengthened Department of Local Finance (MEF) analytical capacity, monitoring and policy analysis functions	Strengthen institutional/functional capacity of the Department of Local Finance.	Design and implement capacity development workshops and discussions for DLF on FD and DLF operational activities. Evaluation Comment: This is accomplished largely through the daily on-the-job training given to the DLF staff.	x	x	x	X
	Strengthen analytical capacity of	Provide analytical training and support on budget	x	x	x	x

Intended Outputs	Indicative Activities		2007			
			Q1	Q2	Q3	Q4
RGC capacity on Fiscal Decentralization			Q1	Q2	Q3	Q4
	DLF officials.	analysis, data management, policy analysis on FD and local government financial issues. Evaluation Comment: This has been accomplished through the use of the financial data available at the MEF. The data is analyzed prior to the field visits and used to train the staff on financial analysis of local governments.				
	Strengthen DLF capacity in monitoring and evaluation (M&E) through on-the-job training during field monitoring visits.	DLF monitoring capacity will be strengthened through participation in field visits to review CS fund flows, own source revenues and local level budgeting and financial management issues. Evaluation Comments: This is accomplished through the regular field visits made to the communes. A schedule of visits over the past year have provided the basis for developing this capacity in the DLF.	x	x	x	x

Intended Outputs	Indicative Activities		2007			
			Q1	Q2	Q3	Q4
RGC capacity on Fiscal Decentralization			Q1	Q2	Q3	Q4
2. Fiscal Decentralization Strategy refinement			Q1	Q2	Q3	Q4
3. Articulated fiscal decentralization policy incorporating the D&D strategic framework and the public financial reforms	Refine FD strategy document to highlight possible directions and sequencing of reform pilots and policies in light of the DD strategic framework, PFM objectives and the ongoing NCDD discussions.	Working with MEF (PFM), refine a draft FD strategy document, which incorporates the D&D strategic framework and PFM objectives. Evaluation Comments: This has been accomplished to the extent that some policy documents have been developed and the product has been incorporated into the FD training program.	x	x	x	
		Assist in facilitating discussions on the draft MEF FD strategy document within the NCDD structure. Evaluation Comments: This has not been accomplished due to the problems with the NCDD creating the necessary organizational structure to provide for discussion on this issue.		x	x	x
3. Improved legal framework and procedures for improving accountability of Sub-national Financial Systems			Q1	Q2	Q3	Q4
1. Improved operations of central-local transfer system, focusing on the Commune/Sangkat Fund	Review the CSF capitalization rate, allocation formula, regulations/procedures.	Work with MEF/NCDD to review CSF policy and operational framework with specific focus on capitalization rate, allocation formula, and regulations/procedures. Evaluation Comment: This activity has been achieved on a daily basis and provided the input to the increase in the C/S Fund allocation for the years 2008-2010.	x			
	Refine and improve information	Using information from MEF National and Provincial	x	x	x	x

Intended Outputs	Indicative Activities	2007			
		Q1	Q2	Q3	Q4
RGC capacity on Fiscal Decentralization					
	system on CSF reporting system.				
	<p>Treasury, improve the CS Fund reporting system (annual, quarterly, as appropriate).</p> <p>Evaluation Comment: This is an ongoing activity to develop more accurate and current information on the use of funds at the commune level.</p>				
	Evaluate release of the CS funds.	x	x	x	x
	<p>Using CS budget financial information database and information from National and Provincial Treasury, assist in evaluating the release of the CS funds, with follow up field visits as appropriate, jointly with officials from MOI.</p> <p>Evaluation Comment: This activity is being implemented through a WB TOR that will examine the flow of funds from the central to the provincial level and define methods to improve the flow of cash payments.</p>				
	Operationalize CS oversight function/ CS Fund Board.			x	x
	<p>Work with MEF/NCDD to develop and evaluate options for CSF oversight and policy until eventual development of a broader intergovernmental fiscal policy management mechanism.</p> <p>Evaluation Comment: This activity is on hold until further development of the NCDD organization.</p>				
	Explore alternatives for broader central-local transfer options to include all sub-national levels.				x
	<p>Work with NCDD/MEF to explore options for introducing a broader central-local transfer mechanism to include all sub-national levels.</p> <p>Evaluation Comment: This activity is on hold until further development of the NCDD organization.</p>				

Intended Outputs	Indicative Activities		2007			
			Q1	Q2	Q3	Q4
RGC capacity on Fiscal Decentralization			Q1	Q2	Q3	Q4
2. Improved sub-national level budgeting and financial management	Evaluate the revenue and expenditure pattern of the CS Budget.	Contract out study under NCDD/MEF on CS level budget implementation experience to identify and resolve planning, budgeting and implementation constraints leading to delays in budget execution and delivery of services and to identify impact of CS budget expenditures for local citizens. Evaluation Comment: This activity is in process pending WB funded study.			x	x
	Explore feasibility of developing district treasuries and/or using commercial bank accounts for CS authorities.	Assist MEF/NCDD to pilot options to improve CS financial management through possible introduction of district treasuries and/or using commercial banks. Evaluation Comment: This activity is planned to be completed later in the year.			x	x
	Monitor CS Budget revenue and expenditure pattern for policy and procedural analysis.	Using CS budget financial information database and information from National/Provincial Treasury, assist MEF/MOI conduct office/field monitoring and evaluation of the revenue and expenditures of the CS budgets, as appropriate. Evaluation Comment: This activity is on going and will be completed later in the year based on study of the disaggregated financial data.		x	x	x
3. Improved sub-national level revenue mobilization	Develop local administrative fees and user charges polices and procedures.	Working with MOI and MEF, assist in identifying administrative fees and user charge options for local authorities, design and implement pilot project. Evaluation Comment: This activity is planned for later in the year under UNCDF funding.			x	x

Intended Outputs	Indicative Activities		2007			
			Q1	Q2	Q3	Q4
RGC capacity on Fiscal Decentralization			Q1	Q2	Q3	Q4
	Develop sub-national revenue policy and systems options.	Working with MEF (DLF and Tax Department), develop sub-national revenue policy and administration systems options. Evaluation Comment: This activity was accomplished as part of the work of Rubi Sagana dealing with the development of property related taxes.		x		
4. Developed pilot mechanism to strengthen the fiscal/financial model of sub-national level authorities	Develop fiscal/financial option for enabling more effective sub-national administration budget formulation, execution and monitoring for accountability.	Work with NCDD/MEF to develop options for piloting improved sub-national planning, budgeting and implementation options to provide efficient and accountable service delivery. (to link with integrated district pilots). Evaluation Comment: This activity has been supported through the missions of Mohamed El Mensi in proposing the two-tier local government system framework.		x	x	x

3.1.5 Effectiveness of the Technical Assistance/Training

This section provides an assessment of the technical assistance and training and the demonstrated impact of these activities on the functions in the MEF organizations that received this assistance. The focus is on how these activities have impacted policy development and the capacity of the MEF to deal with the complex issues surrounding fiscal decentralization. While the above assessment focused on the realization of the components within the work plan, this assessment focuses more on the impact within the organizational structures of the MEF.

The policy impact assessment is based on whether there was a discernible change in the policies and/or procedures that existed in the MEF in performing its functions. It is necessary to look at whether any policy recommendations were incorporated into the strategic or legal frameworks dealing with D & D as well as whether the policy changes recommended impacted the present systems and procedures in the operation of MEF.

The capacity building effectiveness is assessed based on the extent to which new skills or knowledge was provided and whether the abilities of the staff to conduct research and prepare policy documents has been enhanced, demonstrated by some impact on the operations of the MEF.

Public Finance Management D & D Working Group

The expansion of the membership of the D & D Working Group and the development of policy issue papers and forum combines both a policy development impact as well as capacity building of this important organization within the MEF. This has been an effective method to provide both technical assistance and training by the FDSP.

Department of Local Finance

Two significant activities related to the support to the Department of Local Finance indicate that technical assistance and training have been effectively delivered. A weekly training session was held by Dr. Kelly on fiscal decentralization was well received by the five department staff and was even expanded to include staff from other organizations in the MEF, as well as MOI. In addition, the use of the field visits to examine the commune level financial situation and development of budget analysis based on the financial data collected reinforced the training and led to some improvements in the Commune/Sangkat Fund operation.

Two staff members of the department were also sent to the Duke University program on fiscal decentralization and local government. This provided more longer-term capacity development and exposure to the international experiences in fiscal decentralization and local government finance.

Tax Department

While the Tax Department was not originally envisioned as an organization to receive direct support under the FDSP, it developed that the Tax Department has become a strategic and significant participant in the development and delivery of the technical assistance and training. This technical assistance began with support in developing a property tax system option and later included some support on the oil and gas revenue issue, as requested, to be provided by the UNDP Resident Representative. Further support will be provided to the department in areas of

developing the policy options on own source revenues, administrative fees and user charges during the remainder of 2007.

There was some training opportunities provided to the staff at the weekly training sessions conducted by Dr. Kelly and one staff member attended the Duke University course. This participant to the Duke University course has utilized the opportunity to further develop the provisions of the property related taxes.

Commune/Sangkat Fund

While the creation of a Commune/Sangkat Fund Board was not achieved, there was still a substantial amount of technical assistance provided that produced results in the operation of the Commune/Sangkat Fund. The proposal for a Fiscal and Financial Decentralization Committee with a broader mandate to formulate and implement policies for an intergovernmental fiscal transfer system was a good initiative and will provide some policy level input that will be realized in the future discussions on the Organic Law.

The improvements in the flow of funds from the Treasury to the provincial level can be attributed to some extent to the initiative to undertake analysis and study of this problem and providing solutions to the problem. This is still an ongoing activity and should improve the overall financial system associated with the C/S Fund.

The technical assistance provided by Dr. Kelly to the MEF and to the WB in developing the percentages of total national revenues to be allocated to the C/S Fund, represents support that shows immediate and long-term impact of the FDSP. The ratios are set for a three-year period. The previous ratios for 2005 was 2.52%, 2006 was 2.54, and for 2007 the ratio was 2.56. This represented a small increase in the percentage in each of these years.

For the years 2008 through 2010, the analysis of the possible levels of the ratios increased dramatically to 2.7% for 2008, 2.75% for 2009, and 2.8% for 2010. This will substantially increase the contribution to the C/S Fund from the government and enable the communes to be able to fund more projects within these allocations. The WB was appreciative of the support that was provided in analyzing the potential ratios and the capacity of the government to fund these increased allocations levels.

More recently, the continuation of the work on identifying a district level financial management system, based on the previously established commune system as well as the conceptualization of this 2-tier financial system, has been developed and presented. This is another good application of the technical assistance that the FDSP has provided on some important financial management issues related to the development of fiscal decentralization in Cambodia.

Economics and Finance Institute (EFI)

The support to the Economics and Finance Institute has been focused on delivery of training courses rather than on policy development. Also, the support has not been particularly focused on the capacity development of the EFI as this is not one of the work activities or focus on the FDSP. This is an area that has potential for further development of support to this institution.

The FDSP provided one course on fiscal decentralization in 2006 and provided two courses in 2007. A second course provided in 2007 concerned project appraisal and risk management. The intention is to offer the fiscal decentralization course at least twice a year in the future.

The completion rate for those participating in the fiscal decentralization course seems quite good. Out of 33 attendees, 27 completed the course successfully. The potential and interest in this course seems quite good and there is possibility that the local staff are capable of delivering the course lectures for this subject following the departure of the Fiscal Decentralization Advisor.

Additional courses are being developed for the EFI. At the request of the UNDP Resident Representative, a course on capital expenditure decisions was developed and delivered in May 2007. Other courses that the EFI would like to develop with some assistance are those that would support the Platform 2 requirements of the PFM RP. These include budgeting courses, revenue forecasting, business process design, procurement, and other public finance management related courses.

The training provided to the EFI is rated as effective and has even more potential in the coming months as well. Further capacity building of the EFI should be considered in future projects supported by UNDP/UNCDF. The course outline and contents of the Fiscal Decentralization in Cambodia is provided in Appendix 4 to this report.

Training at Duke University Program on Fiscal Decentralization and Local Government Finance

The sending of MEF and MoI staff to the Duke University course on Fiscal Decentralization and Local Government Finance has been well received and appreciated by the participants. Five people have been sent to the three-week course through 2006 and two more are planned for 2007. The content of the course presents the theoretical and practical aspects of decentralization. It examines the four pillars of decentralization from (1) revenue assignments, (2) expenditure assignments, (3) intergovernmental transfer systems, and (4) debt and borrowing capacity related to capital investments. The course provided instruction in the delivery of services through privatization, public-private partnerships, and other approaches, such as contracting out. Case studies and field visits enhanced the learning experience of the participants. The course outline of the Duke University course is provided in Appendix 5 to this report. The effectiveness of the course and its potential impact on capacity building and knowledge development of the staff within these organizations seems to have achieved results. The course provides an excellent exposure to international experiences with participants from other countries. In discussing the course with those who had attended it was indicated that this opportunity to hear these international experiences and to make contact with counterparts in governments from other countries was an excellent feature of the course. The impact of the course lasts longer than just the three weeks spent at the Duke University campus. The participants maintain contact with others through an alumni group and also are able to maintain access to library resources to provide them opportunity to continue to research particular aspects of fiscal decentralization. While the cost of the course at \$11,500 is considered to be rather expensive, the international reputation and quality of the program and instruction makes this a good investment in the future development of the participants who have attended the course.

A longer lasting impact of the training provided by the Duke University program would be to provide a small group of people who attended the course that are capable to provide training courses in the EFI or other situations. This would be a sustainable and long-term impact of the Duke University program that needs to be further exploited.

3.1.6 Sustainability of the Results

The above report sections have addressed the impacts of the FDSP in the policy and capacity building areas. In this section, the issue of sustainability is addressed and summarized based on the assessments provided above.

The capacity building aspects described in the areas of training to the organizations within the MEF are the more sustainable features of the project. These capabilities in the Department of Local Finance, Tax Department, EFI and the D & D Working Group are important sustainable results that can be attributed to the FDSP. The impact of the training will have longer term effects as hopefully the NCDD begins to organize the subcommittees and the knowledge provided through the training to the MEF staffers will have significant influence on the provisions relating to fiscal decentralization in the Organic Law, as well as the other legal frameworks that will be needed. These include a local revenue law that could incorporate property related taxes and a fees and charges law for local services.

Sustainable results in the policy area focus on the improvement in the Commune/Sangkat Fund flows and the increase in the allocation percentages of the total national revenues allocated to the C/S Fund that will be in effect through 2010. Since there is no present alternative to the continuation of the C/S Fund, the impacts on the funding flows to the communes and the increased allocations will have a substantial and sustainable impact for the foreseeable future. Even if there are other transfer fund mechanisms developed in the future, the practices, methods and procedures that have been implemented as part of the C/S Fund will likely provide the basis as well as the experience for the operation of these funds. So, the successful effort to improve the C/S Fund should have long lasting impacts.

The less sustainable impacts of the FDSP are more in the area of support to the development of the Organic Law, though substantial effort was made in this regard. In addition, the failure to operationalize the Commune/Sangkat Fund Board as well as pilot the commercial bank accounts for the C/S Fund represent some failure to meet the potential sustainable impacts expected of the project during this period of operation. Additionally, the stoppage of the service delivery activities pending the development of the Organic Law represents another area where the results cannot be shown to be sustainable at this time.

3.2 Observations and Lessons Learned

One of the key observations made regarding the results of the FDSP is that those activities that are internally connected to the work within the Ministry of Economy and Finance were generally accomplished and good results were achieved. Those activities that were related to policy development that involved communication and coordination external to the MEF, particularly with the MoI, were much less successful.

This is generally the case with most decentralization related projects. Given that the MEF demonstrated particular interest and ownership of the project they were quite willing to put the time and attention into those areas where the project had relevance.

The general lesson to be learned in designing and delivering a decentralization project is to pay particular attention to those activities in which the project has a high level of relevance and is within the resources of the host organization to provide the necessary support. In reviewing the accomplishments of the FDSP as presented below it is clear that those achievements that were fully achieved were within the control of the FDSP and MEF to implement, those achievements partially accomplished were dependent to some extent on the relationship with the

MOI/NCDD, and those not achieved were mainly due to national level policy decisions that were not within the full control or influence of the FDSP.

Achievements of the FDSP

Fully Achieved:

- MEF D & D Working Group expanded to all eleven major departments and effectively organized to identify and research issues in FD
- Substantial increase in the national revenue allocation to the communes from the C/S Fund for 208-2010
- Inclusion of FD indicator (#15) into the PFM Reform Program
- Seven officials sent to the Duke University course on Fiscal Decentralization and Local Government
- Increased understanding of FD through 3-week training course Designing Fiscal Decentralization Strategy for Cambodia to 33 officials
- Increased capacity of the EFI to provide training from development of additional courses, such as Project Appraisal and Capital Investment Planning
- Increased capacity of the Department of Local Finance through weekly training sessions and the use of field visits to examine issues related to the C/S Fund flows
- Major research projects completed on Local Revenues and Commune Service Delivery with the Cambodian Research Development Institute with research papers published and conferences held on these topics
- Developed recommendations incorporated into a sub decree that was enacted to improve the timing of the estimation of the funds to be allocated to the communes for better financial planning by the communes
- Major policy papers on sub national budget framework, operation of the C/S Fund at District level, property related taxes and legal framework options for FD were prepared as input to national level policy making
- Effective liaison with other D & D Working Groups from the donor community and the NGO sector
- Development of Revenue Options Paper to contribute to the accomplishment of PFM Fiscal Decentralization Performance Indicator # 15
- Development of the capacity of the Tax Department in technical areas such as property related taxes, oil and gas revenue options.

These were fully achieved primarily due to the fact that these activities were within the control of the FDSP project staff and the MEF staff to accomplish.

Partial Achievements:

- Limited liaison effected with the MOI/NCDD on completion of FD policy papers to be incorporated into the Organic Law
- Limited development of FD policy and implementation strategy framework papers
- Limited development of design of sub national budgeting and financial management system pending completion of Organic Law

These activities were only partially achieved due to the problems with communication and coordination with the MOI/IMC/NCDD and the organizational structures were not created by

Achievements of the FDSP

the NCDD to provide a basis for accomplishing these activities to a greater degree.

Not Achieved:

- Organization and Operation of the C/S Fund Board
- Commercial Bank Accounts for the Communes for C/S Fund
- Full set of legal frameworks for local governments to include Organic Law, local revenue law and intergovernmental transfer system and accompanying regulations on sub national budget and financial management system
- Piloting of commune service delivery activities

These activities were not achieved due to national level policy decisions that precluded their achievement or further development of these activities due to not willing to pre-empt the development of the Organic Law

Chapter 4 - Assessment of the FDSP Program Design and Management in the Ministry of Economy and Finance (MEF)

In this chapter we examine a number of issues related to the implementation of the program and the management of this NEX project within the Ministry of Economy and Finance. There are several areas in which the TOR provided some direction in measuring the extent to which the MEF was involved in the development and implementation of the program. These are highlighted in the following areas.

4.1 Assessment of the Program Design

As mentioned in earlier sections, the impact of the National Strategy for D & D greatly altered the political and policy environment from which the original design of the project was conceived. This caused a refocus on the Program Design from the Commune/Sangkat direction to the provincial/district levels and the targeted organizations within the MEF to receive the technical and training assistance of the FDSP.

This situation was recognized by the Fiscal Decentralization Advisor and along with support from other UNCDF consultant, Mohamed El-Mensi, the design of the original program was examined and modifications to the work plan were made, but retaining the original intention to implement fiscal decentralization from the central to the commune level. The project document was not changed to reflect the new direction of the FDSP.

This changing of the program design and the modification of the work plan was done through coordinated effort with the MEF National Program Director and the staff of the MEF. They were fully engaged in the need for the changes and the requirements to implement new activities to broaden the scope of the work and the organizations to be provided support.

Also discussions were held with UNDP on the development of the project document, the relationship of the project to the wider UNDP programming in decentralization, and the specifics of the work plan as finally approved.

Based on this capability to adapt to the changing situation of D & D strategy, there is a positive assessment of the program design within the overall parameters of the originally conceived FDSP project document.

4.2 Institutional and Implementation Arrangements

The project document provided that the Ministry of Economy and Finance would be the national execution agency, with the UNCDF being the implementing agency representing the UNDP/UNCDF cooperation on the project. Based on the interviews conducted, the MEF understood the nature of the NEX execution and fulfilled the role of monitoring the administration of funds, personnel and other resources that came under the purview of the National Program Director within the MEF.

The interest and support provided to the implementation of the project from the MEF is also well regarded in the context of the NEX execution. The Fiscal Decentralization Advisor was provided an office next to the National Program Director making for easy accessibility to resolve

any issues or problems. The MEF provided support in organizing meetings, seminars and visits to the field to meet with provincial, district and commune officials that is an important feature of this project. The staff of the Department of Local Finance has been especially cooperative and helpful in providing this support. Overall, the institutional and implementation arrangements with the NEX agency seem to have been understood and accomplished at a very high level of support and cooperation to implement the FDSP activities. The continuing level of interest by the National Program Director in the activities of the Fiscal Decentralization Advisor to discuss the implementation of the project activities in such areas as training, expansion of the Working Group, the logistical support provided to project staff, the control and approval of the incentive payments point to a high level of understanding and support for the project in fulfilling the requirements under the NEX modality.

4.3 Program Management

The support for the project from the MEF National Program Director provides an example of how much interest and support the project received from within the MEF structure. The National Program Director was briefed on the work plan with appropriate input into the activities to be developed, there was agreement and clearance on TORs and the work of the consultants that came during the program period with briefings and debriefing sessions, review of mission reports, and monitoring of the approved expenditures from the MEF accessible funds and the local staffing of the project.

4.4 Observations and Lessons Learned

The most significant observation regarding the implementation of the FDSP within the MEF is the significant level of support, cooperation and interest by the National Program Director to fulfill the requirements of the NEX implementation mode. Additionally, there was substantial interest by the Department of Local Finance, and other departments, particularly the Tax Department and the Economics and Finance Institute, to also take advantage of the capacity building aspects of the project. Additionally, the expansion of the D & D Working Group provided an opportunity to reach more organizations and develop the knowledge and skills needed to implement decentralization on a more comprehensive and coordinated basis.

A good lesson to be learned from this is that the success of a decentralization project within a ministry can be greatly enhanced by broadening the scope of the project and taking advantage of the full range of organizational structures within the ministry. A second lesson is that the project success is highly dependent on the level of interest, support and commitment of the National Program Director under a NEX project. This was achieved in the FDSP and is a significant factor in the successes that the project achieved.

Chapter 5 - Implementation of FDSP by UNDP/UNCDF

5.1 Management Arrangements of the Project

The management arrangements of the project represents a rather confused situation and much discussion have focused on this over the course of the evaluation mission. There are several reasons for some misunderstanding or lack of clarification of what the management arrangement was to be from the beginning of the project.

The first of these is the turnover of personnel within UNDP and UNCDF offices at the initial stages of the project. A second factor is despite that a Memorandum of Understanding was developed for a predecessor joint project of UNDP/UNCDF, it appears that no Memorandum of Understanding was signed between UNDP/UNCDF for this component of the Decentralization Support Program. A third factor was that UNCDF did not have a physical presence in Cambodia during this period and the program management support was based in the New York City office of UNCDF. There was a high turnover of UNCDF program management staff in this period and a lack of continuity and institutional memory of the arrangements resulted. The lack of in-country office presence by UNCDF and the problems from the New York City office meant that UNDP had to assume some of the administrative, logistical and financial support requirements that were not originally envisioned in the project.

The role of UNDP and UNCDF in the project is therefore not clear or transparent based on the documents, or lack of documents, available for review. There is some perception that UNDP was simply a donor to the project and therefore would have less input into the actual operation of the activities being undertaken by UNCDF. The project document indicates that UNCDF would be the implementing agency and that UNCDF would receive the funds from UNDP and manage all resources and payments during the course of the project. This was not to be the case over the course of the project.

In the following paragraphs some aspects of the project management are examined based on the interviews that were conducted with those UNDP and UNCDF staff that had some recollection of the history of the project over this period.

5.1.1 Project Document Development

The Project Document for the FDSP was largely developed by the UNCDF technical advisor support and discussed with the UNDP governance staff at the beginning of the project.

There appears to have been at least general understanding and acceptance of the project, which focused on the commune level support based on the local government framework existing at that time. However, following the issuance of the National Strategy for D & D the work plans were changed to reflect the new policy directions and new components were added to reflect these changes. No further modifications of the Project Document were made, but later components and the work plan activities were modified.

5.1.2 Project Management Agreements

There was no formalized Memorandum of Understanding detailing the project management arrangements for the FDSP. It may have been assumed that previous Memorandum of

Understanding between UNDP/UNCDF would be applied to this project. However, the circumstances of the UNCDF not having a physical presence in the country, the project management being based in New York City, and the turnover of personnel in both UNDP and UNCDF lead to the confusion about the project management arrangements. There was no documentation provided by either UNDP or UNCDF that addressed the discussions on the arrangements during the formulation period of this project and the project document. Given that most of the people involved during this period have left UNDP and UNCDF it is difficult to assess what the understandings were concerning the responsibilities between UNDP and UNCDF for this project. The issue boils down to whether the UNDP perceived its role as being more than just a donor and would be actively involved in the development, implementation and monitoring of the project. If the project had continued under the understanding of the previously existing MOU this relationship would have been more clear to both sides and apparently was an arrangement that had worked well in the past.

This was apparently not the view of Leonardo Romeo of UNCDF who was and still is intimately involved with the project from the beginning. The following is excerpt from the comments provided by Mr. Romeo on this issue of the project document, MOU, and the sharing of project arrangements. *“The project document did not foresee the establishment of an MOU, because it assumed that the “implementation support function” in this NEX project had to be assumed **in full and exclusively by UNCDF** (in other terms the original assumption was that there was no need to clarify the “sharing” of responsibilities between UNDP and UNCDF in supporting the FDSP implementation, because there was.... nothing to share).”*

If the above interpretation is the original concept of the arrangement, then one has to assume that later on when other UNDP staff came to be involved in this project, they did not have this understanding of the arrangement between UNCDF and UNDP and assumed that UNDP had a more active role in overseeing and monitoring the project activities, reports, and financial arrangements.

5.1.3 Workplan Development/Approvals

As indicated previously, the components and activities were modified following the issuance of the Strategic Framework and the new work plan was developed on arrival of the Fiscal Decentralization Advisor in August 2005. There was substantial discussion concerning these changes with the MEF National Program Director as the NEX agency for the project. The work plan was also reviewed with the UNDP staff after its formulation and agreement was reached on the appropriateness and relevance of the activities to be undertaken by the FDSP.

5.1.4 TOR Development/Approvals

The development and approvals of TORs for the short-term consultants that came in was not regularized over the course of the project. There were indications that some UNCDF consultants in the period prior to August 2005 would arrive in country, perform their work and depart without contact with the UNDP governance staff concerned with the project. This situation improved following the arrival of Dr Kelly, the fiscal decentralization advisor, in August 2005.

5.1.5 Progress Reports

The preparation of progress reports was also prepared on a more regular basis following August 2005. A review of these progress reports indicates a very detailed description of the project issues, activities and accomplishment from the period of August 2005 to the present. These

reports have provided much of the basis for the assessment of this project during this evaluation mission.

5.1.6 Financial Reporting

In the course of reviewing the financial situation of the FDSP project, it was learned that an exchange of financial information from both UNDP and UNCDF did not occur. Neither partner to the project had the expenditure information from the other partner so as to ascertain if the budget amounts were meeting estimations or adjustments would need to be made.

One of the reasons for this lack of exchange of information is that the basis for financial reporting on budget line items is not compatible between the two organizations, so that comparison on some basis was not a simple matter.

However, this is not an excuse for the lack of the exchange of financial information between the two organizations that funded the project. This is another indication of the disconnection between the UNDP and UNCDF in implementing the project. However, this appears not to have had any significant negative impact on the project, as there are adequate funds to complete the requirements of the project as planned.

The financial information provided by both organizations for this assessment is basically an item of expenditure report and does not connect the expenditure to a component or work plan activity. Since the UNDP funding was largely for the Fiscal Decentralization Advisor the assessment of those funds are relatively straightforward on a macro level. But since there is not allocation of time of the advisor to specific components or to work activities, there is no basis for making some judgment on the cost effectiveness of the work accomplished.

The UNCDF report was also a line item expenditure report reflecting the fees for the consultants, travel, and per diem costs. But there was no information reported connecting these costs to particular components or activities. Since, the consultants were on a contract fee basis, the assumption has to be made that the project management considered that the work accomplished was reflective of the cost incurred.

5.2 Assessment of the Management of Project Long and Short-term Technical Assistance/Training of the FDSP

The early stages of the management of the project was complicated by the turnover of staff in both UNDP and UNCDF. There was some turnover of program managers at the UNCDF office in New York over the course of the project. However, once the long term Fiscal Decentralization Advisor was in place the management of the long and short-term technical assistance and training that was planned was delivered largely on schedule over the course of the project.

There is perception that short-term consultants were brought in on a timely basis as the need arose for their particular expertise. The project has benefited from the core consultant base of UNCDF, with people that had prior association with UNCDF projects and Cambodia in particular. Such people as Paul Smoke, Larry Schroeder and Mohamad El-Mensi, who have been working in Cambodia on many of the same issues from the previous UNCDF Local Development Project and the initiation of the Commune/Sangkat Fund, were available and could be mobilized as needed without significant problems.

This commitment of UNCDF consultants based largely on these long associations proved invaluable in the management of the technical assistance and training that maintained the

continuity with the previous programs and projects that had been initiated. One example of this is the work of Mohamed El Mensi whose long association with the C/S Fund provided the credibility to the recommendations made in his reports. During the interviews with both RCG government officials and donor organizations, the question was asked about the quality of the consultants that the project fielded. All had positive comments on the consultants that they had encountered. The support provided by Dr. Kelly to the WB on developing the C/S Fund allocation estimates for the future years was particularly noted.

5.3 Assessment of the Long and Short-term Technical Assessment/Training Delivered

The assessment of the long and short-term technical assistance and training delivered through the project is based on review of the activities of the Fiscal Decentralization Advisor and the short-term consultants who came as required.

The Fiscal Decentralization Advisor has proven highly effective in both developing the strong relationship and cooperative basis for implementing the activities of the project. The support from within the MEF and the interest of the ministry staff, both from management and technical level, is a critical requirement if a complex and many faceted projects are to be implemented. There has to be a high level of trust and respect that needs to exist between the long-term project technical staff and the ministry officials. This has been achieved to a high degree over the project assessment period.

In addition to the positive assessment of the relationship of the long-term advisor with the Ministry, there is also the well-received acceptance of the technical assistance and the training provided by the Fiscal Decentralization Advisor. The use of mentoring as well as formal training to improve the technical capacity of the ministry staff has been an excellent aspect of the support provided. This has greatly improved the acceptance of the assistance as it was delivered in a very effective and efficient manner within the ministry, particularly with the Department of Local Finance, and even to other organizations such as the Tax Department and the Economics and Finance Institute that have benefited from the experience and knowledge of the Fiscal Decentralization Advisor. The Fiscal Decentralization Advisor provided important inputs into the provisions of the Organic Law dealing with fiscal decentralization, functioning of sub-national budget processes, and the operation of the Commune/Sangkat Fund.

The Fiscal Decentralization Advisor was also effective in coordination and communication with other donor organizations and providing technical support in some instances, such as with the World Bank on developing the percentages of national revenues to be allocated to the communes from the Commune/Sangkat Fund.

A core group of short-term consultants provided through the UNCDF provided a high level of quality of technical and training support at critical times over the past several years. This is largely due to the short-term consultants, particularly Paul Smoke, Larry Schroeder and Mohamad El-Mensi, having a long-term association with the decentralization effort in Cambodia. In addition, to these consultants, Leonard Romeo, a technical advisor with UNCDF office in New York and also having long association in Cambodia through the development of previous UNCDF projects and particularly the Commune/Sangkat Fund, provided invaluable support in the development of the Project Document and later activities as well.

As the situation developed with the Tax Department for support on development of property related taxes, a short-term consultant, Rubi Sagana, was enlisted and has provided technical

advice and training on this issue. This assistance was well received by the Tax Department as evidenced during the interview with the staff of this department.

In reviewing the mission reports and presentations developed by the short-term consultants, the assessment is that these are of high quality, quite comprehensive in providing information and perspectives on the situation, and offering excellent advice and support to the ministry officials and those that were provided with the training on these issues.

A description of the policy papers and presentations prepared by the short-term consultants is provided in Appendix 3 to this report.

5.4 Assessment of the Use of Financial Resources

The assessment of the use of financial resources is focused on determining two specific aspects of the funds provided by both UNDP and UNCDF for the FDSP. The first area examined was the extent to which the full amount of funding provided and available was expended over the life of the project. The total funding from both sources amounted to \$1,490,900 with UNDP contributing \$920,300 and UNCDF providing \$570,600.

Based on financial reports provided by UNDP for the period through the end of the project in July 2007, the total expenditures should amount to approximately \$892,000 leaving a balance of \$28,000 unused. The expenditure percentage is 97% of the funds provided. The largest portion of the funds expended by UNDP is for the support of the Fiscal Decentralization Advisor positioned in the MEF. This amount to nearly 80% of the total UNDP funds based on a contract made with Duke University for these services.

The UNCDF with a total of \$570,600 contributed to the project had expended \$461,000 through the reporting period in 2007. This left a balance of \$108,000 for the remainder of the year to be utilized for additional support of the short-term consultants and the participants to the Duke University Fiscal Decentralization Course. However, there is an estimated additional \$90,000 to be expended for short-term consultants to complete some areas of the work plan through the end of the 2007. If these are realized, the total expenditures will amount to 97% of the funds provided by UNCDF for the project.

The expenditure of funds by UNDP and UNCDF for the years 2004-2007 is presented in the following table.

	2004	2005	2006	2007
UNDP - \$	\$78,092	\$81,684	\$451,601	\$308,923
%	8	8	49	33
UNCDF - \$	\$146,395	\$171,433	\$109,213	\$124,942(est.)
%	25	30	19	21

The low expenditure level for UNDP in the 2004-2005 period is due to the Fiscal Decentralization Advisor not being recruited on a full time basis until 2006. The majority of the funds expended by UNDP were for the support of the Fiscal Decentralization Advisor.

Based on this analysis, the second aspect of the assessment of the use of financial resources is whether there are sufficient funds to complete the programming activities and pay for the staff and other expenses associated with the project to its termination in 2007. It appears from the financial reports that there are sufficient funds with some cushion for unexpected expenses to complete the full financing of the project.

One other issue emerged in examining the use of funds by UNDP and UNCDF in this project. Some funds were paid to RCG employees within the MEF for their activities in support of the FDSP. This included the National Program Director as well as other senior level staff. These payments were made as an incentive for their providing certain activities in support of the Commune/Sangkat Fund as well as participating in forums, conferences and other activities to promote fiscal decentralization. The basis for these payments was a signed agreement with these staff and it appears that this payment policy is a common feature within the government and the donors for such projects. The activities were well documented in reports and supported by timesheets approved by the UNDP and UNCDF representative.

This assessment does not cover whether these payments should or should have not been made. This decision was made in the best interests of the project. However, it also seems that this payment approach is a source of controversy within the donor community. If the project is to continue, it is recommended that these payments be reviewed and assessed prior to continuing the project.

While these types of incentive payments have been utilized by UNDP in other projects under the name of Capacity Building Facilities, they have been very controversial and UNDP has certain guidelines on how these payment facilities should be used. The UNDP policies on these payments should be reviewed if the project should be continued and supported by RCG staff within the MEF.

5.5 Donor/Stakeholder Perspective on the FDSP

The discussions with the other donors involved in the decentralization programming in Cambodia was an area covered during the interviews. Several perspectives were apparent during the course of these discussions. Most recognized the difficulties of promoting decentralization during the past several years given the circumstances within the RCG. While they believed that the FDSP had some impact and certainly raised the visibility of the technical support to this area with high quality technical assistance and training delivered, the external factors that each donor also faced indicated that the FDSP could not achieve all that had been initially expected.

The donors also appreciated the cooperation and liaison that was maintained by the project with other donor programs by the FDSP project staff and by the UNDP as well. This was a substantially different perspective over the past six months with more interaction of the UNDP with the donors and the working groups associated with the donor projects.

There was some confusion or apparent lack of knowledge about how the project was implemented and the role of the UNDP and UNCDF in the project. Most of those interviewed were more aware of the project as a UNCDF project, rather than as joint project of UNDP/UNCDF. This is understandable given the long association of UNCDF in Cambodia over the past decade as well as the visibility of the UNCDF consultants who have had a long

involvement with the decentralization effort. This perception seemed to persist even though UNDP has had a long period of continuous support in Cambodia beginning in 1993 and initiated the CARERE project. This perception may be due more to the duration of the donor community advisors who stay three to five years and lack the longer-term perspective on the involvement of the UNDP in Cambodia.

5.6 Observations and Lessons Learned

Of all the areas in which this evaluation has examined and addressed, the implementation arrangements of the project between UNDP and UNCDF shows the most need for improvement and the learning of lessons in order to prevent some of the confusion that arose during the project life.

The need to maintain continuity of project and program management staff from the beginning of the project is the first area of concern. The amount of personnel turnover at the early stages of the project coupled with the absence of a Memorandum of Understanding led to some misunderstandings as to what the role of the two organizations were from the beginning. From this situation, the reporting on the progress and the financial aspects of the project were not consistently developed or maintained for the past several years.

The lesson to be learned from this is that there is a need for a formalized agreement dealing with program management, financial resources and the reporting of both progress and finances over the life of the project if misunderstandings are to be avoided. While there is no evidence that this situation seriously affected the implementation of the FDSP, it does indicate that the two organizations could have worked better and more cooperatively over the joint use of the funds that were provided to support the project.

Chapter 5: Recommendations

5.4	While these types of incentive payments have been utilized by UNDP in other projects under the name of Capacity Building Facilities, they have been very controversial and UNDP has certain guidelines on how these payment facilities should be used. The UNDP policies on these payments should be reviewed if the project should be continued and supported by RCG staff within the MEF.
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Chapter 6 - Future Support to Fiscal Decentralization

6.1 Present Status of the FDSP

The FDSP is drawing to a close in the coming months. UNDP activity in the project, including the financial support for the Fiscal Decentralization Advisor, will end in the period July-August 2007. There are no major commitments that UNDP will need to complete other than make final payment for the Duke University contract and salaries for the local staff.

UNCDF, with additional resources, has an intention to continue support for the remainder of 2007 to the MEF, with short-term consultants being provided to complete some particular studies in the areas of own source revenues, local government finance management, continued development of the sub-national financial management system at the district level, and the development of property related taxes.

UNCDF has developed a proposal with the Government for continuation of the project beyond the end of 2007. This proposal is still being developed and the exact nature and participation of UNDP to continue its involvement is one of the options discussed below.

6.2 Short-term Project Activities through 2007

There is a work plan developed for continuing the FDSP activities through the end of 2007. Several of these activities are particularly important and need to be pursued given that there is a need to maintain some support to the MEF without some abrupt halt and until a new project can be put into place.

Some of the critical project activities that are programmed and can be completed in the coming months include developing commune level budget analysis based on disaggregated data, continuing field trips to communes to gather additional information on the development of commune level budgets, continue some improvements in the C/S Funds allocation, and develop some input on own-source revenues as well as the property related taxes. These activities, as well as the capacity building and knowledge sharing activities, such as sending two more participants to the Duke University Fiscal Decentralization course and other training, can be successfully completed. While the departure of the Fiscal Decentralization Advisor will occur in June there is still provision for continuing these activities. The primary difficulty to be overcome due to the departure of the Fiscal Decentralization Advisor will be to find a replacement without too great a gap in time. But the more difficult problem will be to find a replacement that can achieve the same level of personal relationship and technical credibility that the present advisor enjoys within the MEF.

6.3 Energizing the National Level Dialogue on Fiscal Decentralization

A distinguishing feature of the effort to promote D & D, including fiscal decentralization, in Cambodia is the limited extent to which the issues are debated within the governmental organizations and in the social institutions and stakeholders that have some interest in promoting decentralization.

In most of the transition countries, the issues surrounding decentralization is a very controversial and hotly debated topic within the society. The stakeholders at the local level, including NGOs and other civil society organizations, are intimately involved in promoting decentralization. The debate is a part of the political process in many cases and forms the basis for platforms in political campaigns.

The issue of the drafting of the Organic Law within the RCG illustrates how unusual the debate or even dialogue concerning D & D is in Cambodia. The complete draft of the Organic Law has not been revealed and there has been little opportunity, even by those ministries represented within the IMC/NCDD, which is to produce the draft, to know or even provide input into the draft. Some requests for obtaining the draft have been refused even to representatives of ministries, such as the MEF.

This issue was discussed in a meeting with a representative of the MoI in asking how the development of D & D could be promoted through a more open debate and dialogue within government as well as with the donor community, commune associations, and civil society organizations.

Some interest was expressed that using the commune association as a means to develop the dialogue from a bottom-up mechanism would be useful. This could be accomplished at the conference of commune association and there could be other possibilities through holding of seminars or other conferences or workshops.

Some consideration needs to be given as part of the development of a new FDSP successor project on the development of some approaches to improving the dialogue on the implementation of D & D, as well as fiscal decentralization.

6.4 Program Options for Promoting Progress on Fiscal Decentralization

With the expiration of the FDSP in the coming months, there is need to identify some programming options available to UNDP and UNCDF to continue the support to the fiscal decentralization progress in Cambodia. UNDP and UNCDF have been the earliest and most continuous supporters of decentralization and is a core area of activity by both organizations in Cambodia. In addition, there has been a substantial financial as well as human resource investment by UNDP and UNCDF that would be lost if further programming activity is not continued. Both organizations would stand to lose their leadership role within the donor community for promoting decentralization.

Three options for continuing the programming for fiscal decentralization are proposed below for further examination and discussion between UNDP and UNCDF in the coming weeks.

6.4.1 Continuation of Support

The first option would be to consider a continuation of the joint partnership of UNDP and UNCDF to support the fiscal decentralization agenda. With the UNDP support ending in mid-2007 and UNCDF continuing with support for activities through the end of 2007, there is a need to see how the results of the present FDSP can be leveraged and the investment sustained from the accomplishments of the FDSP.

UNCDF has prepared a project document that to some extent continues some of the components of the FDSP under the title of an Innovations for Decentralization and Local

Development (IDLD) with four components: (1) developing the Sub-National Democratic Development Program (SNDD), (2) advancing the fiscal decentralization reforms process, (3) deepening the ongoing “District Initiative” and supporting the emergence of the 2-tier local authorities system, and (4) improving the PSDD and SNDD M&E system. Components 1 and 2 are particularly relevant to the continuation of a joint program and funding from UNDP and UNCDF partnership.

The project document as presently existing provides that the World Bank will provide parallel funding through the RILG Additional Financing for several key identified activities such as a resident FD advisor, FD studies, and support to the development of the national SNDD program. The initial allocation of funding incorporates about \$1.5 million in parallel funding from the World Bank with UNCDF providing \$1.6 of their resources. DANIDA is also presented as providing possible parallel funding contributor for \$250,000, but there is still a need for an additional \$695,000 that would need to be funded to bring the project up to its full funding requirements.

The role of UNDP has not been clarified in the project document among the various components and activities. The World Bank has indicated it would provide funding to the RGC to fund a Fiscal Decentralization Advisor that would be working closely within the NCDD structure, with strong linkages in the Ministry of Economy and Finance and to strengthen the linkages between the Ministry of Interior and the Ministry of Finance to better coordinate and develop the communication for the promotion of the D & D effort.

UNDP could join this initiative through providing funding to the components and activities as identified, or alternatively could fund some additional activities within the components that are yet to be identified.

Some modifications to the project document are being developed and the potential for further involvement in this IDLD that is compatible with present UNDP programming, such as support to the PSDD, Commune/Sangkat Fund management, and other policy level inputs, should be considered.

6.4.2 Areas for UNDP Capacity Building Support in MEF

A second alternative would be for UNDP to develop its own Capacity Building Support program to continue the activities started under the FDSP. One of the major results of the FDSP in the MEF was to increase the knowledge level and skills of the MEF staff in the areas of local government expenditure and revenue analysis, policy implications of transfer systems, and the functioning of budget and financial reporting systems at the sub-national level.

If the FDSP, or similar effort, is not continued within the MEF, then much of the investment in this capacity building will be lost in the coming months. Therefore, the sustainability of the FDSP results will be lost.

This alternative would build on the present strong relationship of the FDSP within the MEF, but focus more on capacity building than on policy analysis and development.

The program would still focus on the Department of Local Finance as the main counterpart organization. The training and capacity building activities already initiated would be continued and expanded to the staff of the department, such as additional training opportunities with Duke University or other training institutions.

Another priority organization for support would be greater involvement with the Tax Department and an emphasis on local government revenue mobilization. The already existing support for the property related taxes, oil and gas revenues, and additional tax and revenue issues would be a major policy focus for this part of the project. The emphasis would be on increasing the skills and knowledge of the Tax Department staff to perform more complex economic analyses of tax and revenue sources, as well as revenue forecasting methods.

The Economics and Finance Institute would also be supported with additional provision of course development and curriculum in areas of budgeting methods, revenue forecasting and specialized courses based on needs assessment made for the Economics and Finance Institute.

A long-term tax and revenue policy advisor would support the accomplishment of these capacity building activities. This person could complement the Fiscal Decentralization Advisor being funded separately through the World Bank under the RILG Additional Financing. Also, the advisor could support the development of the local finance issues as they are to be addressed by the NCDD subcommittee on financial issues and the MoI NCDD Secretariat.”

6.4.3 Areas for Joint UNDP/WB PFMRP Support

The World Bank Public Financial Management Reform Program as described earlier is the most comprehensive effort to development of public finance management reform in Cambodia. The Multi Donor Trust Fund that the World Bank administers sponsors the activities under this project. While there are numerous donors that support the project, there are only four donors that are actually putting funds into the MDTF. These are WB, AusAID, DFID and the EC. There is interest on the part of the fund managers to attract more donors and funds to this effort. The UNDP with some additional funding could support some broader financial management reform activities, as well as the fiscal decentralization activities that are now incorporated into the PFMRP.

A number of areas that could be supported by UNDP are the development of a more comprehensive Medium Term Budget Framework (MTBF) to build on the limited development of a MTBF that now exists at only the top level of the process. This activity could be implemented through support to several ministries to increase their capacity to implement the process, build the analytical capability to formulate programs and budgets that would improve the flow of funds to the local government levels for particular sectors, such as education, health, water and other needs.

The EAP report cited earlier also identifies the need to develop the functional review of the MEF organization. This is another focus area where UNDP expertise and experience might be utilized. The development of functional reviews was a particular emphasis of UNDP in the transition countries of Central and Eastern Europe and the CIS. The methods and techniques of conducting functional reviews could be applied to further support this effort.

The PFMRP also has some focus on fiscal decentralization and this could be another area where UNDP experience of the FDSP could be utilized and the investment of the resources would not be lost following the end of the FDSP.

As the EAP report indicates there is a need to continue some support to finish Platform 1 requirements and develop the strategy and activities for Platform 2. UNDP could support this effort through funding short-term technical assistance to complete critical Platform 1 requirements

It is strategically important that UNDP align its further programming in the financial management and fiscal decentralization area with the PFM RP project. This would enable limited funding to be leveraged with the other donors and also provide the opportunity to focus this funding on specific areas of interest of UNDP to support.

6.5 Strategic Assessments for Future Programming

Based on this evaluation and identification of some programming options outlined above, a further effort should be undertaken to address on a strategic basis the direction of future UNDP/UNCDF programming in support of decentralization. There are a number of issues that could be examined to give more focus and clarity to the direction, intention and methods of supporting the effort toward a decentralized system of governance. A number of these issues arise out of evaluation made of the FDSP during this mission.

The overriding issue that should be addressed is the strategic partnership among the donor community to support fiscal decentralization. With the ending of the FDSP, the ongoing Public Finance Management Reform Program administered by the World Bank, the possible continuation of a separate project by UNCDF designated the Innovations for Decentralization and Local Development, and the ongoing PSSD of the UN and other donors, there appears to be a multiplicity of projects dealing with the issues of decentralization, even within the UN organizational framework. Arising out of this situation is the need for a more strategic framework for donors to cooperate and complement the efforts to influence the RGC structures toward a new effort. The UNDP could play an important role in this effort by examining its own democratic governance and decentralization portfolio to see where present programming and synergies with other UN agencies and donors could lead to a more strategic programming approach. This evaluation did not focus on the other components of the UNDP programming in these areas, but some comparison and evaluation of these programs may be useful in the coming months.

A second issue that bears examining is whether there is more possibility to push forward decentralization through the MoI or the MEF. There is a need to identify a champion for the decentralization effort that will push through the needed government level coordination. The MoI, based on the present record, does not seem to offer this possibility as it focuses more on the political and administrative dimensions of decentralization. MoI does not seem particularly interested to open up the process and dialogue required to develop the policy level consensus that is needed if these reforms are to be implemented.

Another approach to promoting decentralization is through the national level budget decision-making process that is largely under the control of the MEF. If MEF can be the catalyst for some reforms based on the implementation of the PFM RP, particularly with respect to medium term budgeting framework, revenue mobilization and line ministry capacity development to force through some decentralization of service delivery and financial resources, it will provide another avenue to influence the decentralization. Some strategic assessment needs to be made concerning this possibility.

On a more specific level, the future of the Commune/Sangkat Fund and the Provincial Excomm structure and support to communes bears examining as well, to see how these can fit into a future decentralized system of governance with emphasis on fiscal decentralization capacities at the intermediate tier of government. The overall impact of these two features of the present system seem not to have been examined with an intention to see how they fit to future system of government in Cambodia.

Additional technical assistance to evaluate these issues should be considered in the coming months.

Chapter 6: Recommendations

6.3	Some consideration needs to be given as part of the development of a new FDSP successor project on the development of some approaches to improving the dialogue on the implementation of D & D, as well as fiscal decentralization.
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Appendix 1 - List of People Consulted

Royal Government of Cambodia

Ministry of Economy and Finance:

Sim Eang, Director, Tax Department

Chou Kimleng, Deputy Secretary General

Dr. Sok Saravuth, Director, Budget Department

Um Seiha, First Deputy Director, Tax Department

Chan Thy, Chief of Local Finance Unit, Department of Local Finance

Ministry of Interior:

Chamroeun Ngan, Deputy Director General, General Department of Administration

Siem Reap Provincial, District and Commune Officials:

ExComm Members and Staff, treasury and commune accountants, SPPA/PSDD staff of the Provincial Administration

Angkor Chum District Office, District Committee members, Planning Unit, Technical Support Office

Char Chhouk Commune Office: Commune Councils, commune clerks

Sotnikum District Office: District Committee members, Planning Unit, Technical Support Office

Dam Dek Commune Office: Commune Councils, commune clerks

Donor Representatives

UNCDF:

Leonardo Romeo, Technical Advisor, UNCDF, New York (phone interview)

Roger Shotton, Regional Technical Advisor, Asia

Paul Smoke, UNCDF Consultant, New York University (phone interview)

UNDP:

Dr Edilberto C. Angeles, Senior Finance and Administration Advisor, PSDD

Jacinta Barrins, Decentralization Advisor

Anne-Isabelle Degryse-Blateau, Program Director and Deputy Resident Representative

Nhim Hak, Senior Provincial Program Advisor

Dr. Roy Kelly, Fiscal Decentralization Advisor

Mohamed El-Mensi, Fiscal Decentralization Advisor, Decentralization and Local Development Support Project-DLSP

Scott Leiper, Senior Program Advisor, PSDD

Min Muny, Program Manager Governance Cluster

Sara Ferrer Olivella, Assistant Resident Representative, and Governance Team Leader

Michael Otto, Governance Specialist, Governance Cluster

Sang Polrith, District Initiative Program Advisor, PSDD

Thach Savy, Finance System Advisor, PSDD

Danish DANIDA:

Mogens Laumand Christensen, Minister Counselor, Danida Resident Representative

International Monetary Fund:

Sodeth Ly, Economist

Swedish SIDA:

Erik Illes, First Secretary, Embassy of Sweden

World Bank:

Louise Fallon Scura, Lead Natural Resources Economist

Robert R Taliercio, Senior Country Economist

FDSP:

Lim Chheng, National Local Finance Advisor

Appendix 2 - List of Documents Reviewed

Decentralization Support Program Documents

UNDP ProDoc: Project of the Royal Government of Cambodia—Support to Decentralization (CMB/01/004) 2001

Final ProDoc DSP Fiscal Decentralization July 2004

Cambodia ProDoc PSDD 2006-2010

Fiscal Decentralization Support Programme (FDSP) Documents

Project Document Fiscal Decentralization Support Programme (FDSP)

2006 Annual Report FDSP-Final

FDSP Work Program 2006

Fiscal Decentralization Support Components (2001-2006): A Submission for the Decentralization Support Project (DSP) Project Completion Report (PCR), January 2007

FDSP Progress Reports

UNDP/UNCDF Progress Report August 2005-May 2006

UNDP/UNCDF Progress Report June 2006-October 2006

UNDP/UNCDF Progress Report November 2006-March 2007

Cambodia - Decentralization Support Project Fiscal Decentralization Component (DSP-FD) Independent Review of the FDSP, Roy Kelly, 30 April-8 May 2005

FDSP Reports/Presentations

Developing a Fiscal Financial Model: The District-Commune Structure, (PowerPoint) May 2007

Fiscal Decentralization in Cambodia (PowerPoint) Presentation to UNICEF Cambodia, May 2007

Sub-National Budget Framework in the Context of Decentralization and Deconcentration Reforms, prepared by Mohamed El-Mensi, 11 Sept-1 October 2006

Study of Local Service Delivery, Final Report 2nd Draft, Cambodia Development Resource Institute (CDRI), 2005

Local Service Delivery: Experiences from Communes/Sangkat Workshop Report, February 2006

Strategic Framework for Decentralization & De-concentration Reforms, Royal Government of Cambodia, June 2005

Developing Modern Property Tax System in Cambodia (PowerPoint presentation)

Sub-national Governance Authority Finance (Draft) May 2006

Financial Systems in Cambodia (PowerPoint) February 2007

Forecasting Tax Revenues (PowerPoint) April 2007

Lecture 8 – Sub-national Financial Provisions (PowerPoint)

Lecture 9 – Sub-national Budgeting Options-Cambodia, (PowerPoint)

Lecture 10 – Institutionalizing Intergovernmental Fiscal Systems Options for Cambodia (PowerPoint)

UNCDF Mission Report, Mohamed El-Mensi, 16 Sept-1 Oct 2005

UNCDF Mission Report Mohamed El-Mensi, 17 Feb-7 March 2005

UNCDF Mission Report: Fiscal Financial Management Model for the Two-Tier Local Authority System, Mohamed El-Mensi, May 2007

Project to Support Democratic Development through Decentralization and Deconcentration (PSDD): Project Document, January 2007

Public Finance Management Reform Program Documents

2007 External Advisory Panel Report: Public Finance Management Reform Program: Draft, March 2007

2007 External Advisory Panel Report: Final Report, April 2007

WB-Rural Investment for Local Governance Deconcentration: Provincial Budget Operations, Final Report, Anne Bartholomew and Mary Betley, December 2006

Other Reports

A SWOT Analysis of the Cambodian Economy prepared for the Cambodia Economic Forum, UNDP Funded Discussion Paper in cooperation with Supreme National Economic Council and Harvard University Kennedy School of Government, January 2006

Guideline on Implementation of District Initiative Program for 2007, prepared by National Committee for the Management of Decentralization and Deconcentration Reform (NCDD) Working Group, October 2006

Own Revenues for Local Governments in Cambodia, Min Muny, November 2003

Royal Decree on the Establishment of the National Committee for the Management of Decentralization and Deconcentration (unofficial translation)

The Cambodia Aid Effectiveness Report 2007, prepared by Cambodian Rehabilitation and Development Board, Council for the Development of Cambodia, May 2007

Appendix 3 – FDSP Reports/Presentations

Report/Publication Name	Comments
<p>1. Improving Revenue Mobilization in Cambodia: Strategy for Developing a Modern Land and Building Tax, power point presentation prepared by Roy Kelly and Rubi Sagana, April 2007</p>	<p>This power point presentation examines the issue of developing a property related tax system in Cambodia. It provides an examination of the issues in developing property related taxes, indicates the potential for revenue collection from property taxes in Cambodia, and makes some comparison with other South Asia countries, including Thailand, Philippines, Indonesia, Malaysia, among other countries of the region. The presentation makes detailed projects for the implementation of the property tax as it would affect the capital Phnom Penh. The process of implementing a land and building tax is illustrated with the characteristics, organization, and record requirements for property related taxes. The presentation ends with detailed identification of a 4 Phase strategy for implementing property related taxes in Cambodia.</p>
<p>2. Improving Revenue Mobilization in Cambodia: Strategy for Developing a Modern Land and Building Tax, prepared by Roy Kelly and Rubi Sagana, April 2007</p>	<p>This policy paper was prepared for the Ministry of Economy and Finance. It examines in detail the introduction of a property tax on land and buildings that could produce substantial revenue sources to the local and municipal levels. The paper looks at how the property tax could be initially implemented for Phnom Penh. It describes the process of establishing a property registration system. The implementation strategy is described as having three components: (1) political and public support mobilization, (2) existing tax administration improvements, and (3) land and building tax preparation and implementation. The paper provides some detailed tables that estimate the land and building tax base for Phnom Penh. This policy paper is very comprehensive in addressing all the issues in implementation of a property tax to include defining the tax base, rates, and methods of developing the property registration system. It also addresses the use of valuation methods for the different properties and an automated database for maintaining the property system. The paper provides an examination of the organizational structures of a tax department that would needed to maintain the property tax system from registration to valuation and collection of the property taxes.</p>
<p>3. Forecasting Tax Revenues: Techniques and Models, power point presentation prepared by Rubino Sagana,</p>	<p>This is a very technical presentation of methods and techniques of developing revenue forecasting models and their application. It identifies the objectives of a revenue</p>

Report/Publication Name	Comments
April 2007	forecasting model, the stakeholders in developing and using a revenue forecasting model, and some very technical methods of developing the revenue forecasts. The presentation deals with the issue of elasticity in revenue forecasting and the use of the methods of regression analysis, the national accounts approach, and the input-output approach. The presentation ends with a micro simulation example of revenue forecasting.
4. Sub national Budget Framework in the Context of Decentralization and Deconcentration Reforms, prepared by Mohamed El Mensi, September-October 2006	This paper examines the options for developing a provincial and district budgeting and financial system under the Strategic Framework for Decentralization and Deconcentration. The paper presents a four-phase implementation schedule for a new budget and financial system. The preparatory phase begins in 2006 with the development of frameworks and implementation strategies. The initial phase of implementation would begin in 2007-2009 with the establishment of sub national administration structures, election of commune councils and a permanent D & D authority to continue implementation. The transition phase goes from 2010-2012 with evaluation of initial achievements and refinements of the rules and regulations. The transformation phase begin in 2013 with continuing adjustments to the system. The paper presents the budget formats for each level. The district level would become a service delivery level with specific functions and revenue sources. The financial flows in a revised intergovernmental finance system are described with inclusion of block grants and general grants.
5. Sub-national Budget Framework Options prepared by Mohamed El Mensi and Roy Kelly, September 2006	This power point presentation presents the basics of a sub national budget system for Cambodia with a focus on the district level of administration. The presentation reviews the existing sub national organizations and their roles in the financial management system. It proceeds to an examination of the provincial, district and commune level structures and authorities for supporting a sub national budget framework. It ends with a detailed examination of the implementation of a district budget system and the flow of funds with the additional responsibilities placed on the district level with the overall governmental structures.
6. Sub national Governance Authority Finance, a draft of fiscal decentralization provisions to support D & D, prepared by Roy Kelly and Paul Smoke, May 2006, and	This paper defines a legal framework for implementing a sub national financial system in the format of a law with appropriate articles and sub articles with provisions on the principles of sub national finance, the local own source revenues and national level

Report/Publication Name	Comments
revised September 2006	resources, the borrowing provisions for local governments, and the financial management system. It creates the organizational structure for controlling the financial management system through a Fiscal and Finance Decentralization Committee and defines its responsibilities, membership and functions. The provision of a secretariat to support the Fiscal and Finance Decentralization Committee is also indicated. A separate schedule defines the taxing and revenue powers of the central, provincial, district and commune levels of government. A timeframe for implementation of the fiscal decentralization process is attached covering the activities and the years from 2006 to 2016.
7. Lecture 8: Sub national Governance Administrations: Draft Financial Provisions, by Roy Kelly	This power point presentation illustrates the requirements for a sub national financial system. It is a supplement to the paper prepared by Roy Kelly and Paul Smoke on Sub national Governance Authority Finance in Cambodia. The presentation reviews the main articles of a law that establishes a sub national finance system dealing with tax and revenue authorities to each level and the organizational structure for implementing a sub national finance system.
8. Lecture 9: Sub national Budget Options: Cambodia by Roy Kelly	This power point presentation provides a description of the main frameworks for implementing a D & D program in Cambodia. It addresses the need for institutional changes, the establishment of a unified budget system, the development of this budget system at the provincial to the commune level with a focus on the district level and aspects of the district level budget system.
9. Lecture 10: Institutionalizing Intergovernmental Fiscal Systems: Options for Cambodia by Roy Kelly	This presentation provides some options for developing the institutional structures of implementation of an intergovernmental fiscal relations system. The presentation provides examples of how intergovernmental systems are organized based on examples from international experiences. The structures and experiences from India, Pakistan, Australia, Germany, Sri Lanka, Nigeria, Uganda, South Africa, and Papua New Guinea are provided for review and discussion. The presentation ends with some recommendations for Cambodia including the provision for a Fiscal and Finance Decentralization Committee with the MEF playing the role of secretariat to the Committee.
10. UNCDF Mission Report: Sept-October 2005,	This mission report provides information on the support for the development of the

Report/Publication Name	Comments
prepared by Mohammed El Mensi	financial system at the sub national level. It addresses the requirements for implementation of a commercial bank based payment pilot system at the commune level. It describes the process of implementing the pilot and the steps at each organizational level from the MEF to the province, district and commune level. The activities of accountants at each level are described. The appendices to the report provide more detail on the pilot system design, the regulations for the system implementation, guidelines for the financial procedures and an implementation timetable.
11. UNCDF Mission Report, Feb-March 2007, prepared by Mohamed El Mensi	This report focuses on updating the requirements and procedures for the establishment of a commercial bank account system for the commune level. The report presents a revised design of the Bank Account Pilot that was previously prepared. The assignment of responsibilities at the provincial level with a C/S accounting office to manage the bank payment processing and transactions are described. The responsibility for establishing a Monitoring Team is described and the composition of the team is provided. The appendices to the report provide a full description of the pilot design, the regulations for the pilot implementation and guidelines for the financial procedures and an implementation timetable. This report updates the mission report prepared in Sept-October 2005 by El Mensi.
12. Fiscal-Financial Management Model for the Two-Tier Local Authority System, prepared by Mohamed El Mensi, April-May 2007	This paper is the result of a UNCDF mission to design a fiscal-financial model in support of a two-tier local authority system composed of the district-commune levels of government. The paper deals with the need to have a service delivery unit above the commune level to respond to the needs the commune cannot adequately address. It describes the District Initiative Program as a way to test the methods and procedures for the district level to support a new approach to providing services. It also addresses the experience of the One Window Service Office being tested in two districts. The paper examines the functions to be assigned to the commune/Sangkat and district levels. The revenue assignments are also presented for each level and the method of fiscal transfers to the two levels. The budget formats for the district level, as well as the budget classification system, are presented in draft form. The use of the provincial treasury to provide paying agent services is also discussed. The district level treasury functions are also presented to complete the development of the financial arrangements from the provincial to the district levels. The paper also concludes with the description of the

Report/Publication Name	Comments
	steps to implement the two-tier local government authority system over the next several years.
13. Developing a Fiscal-Financial Model: The District-Commune Structure, prepared by Mohamed El Mensi and Roy Kelly, May 2007	This power point presentation complements the policy paper developed for this topic. The presentation reviews the problems of the communes as service delivery units and the use of the district level units to support certain services to the commune level. The presentation then reviews the District Initiative Program and the piloting of the One Window Service office at the district level. The pilots are testing the creation of the district councils, an ombudsman office, the creation of one-window service offices, and the restructuring of the District Administration. The presentation provides a description of the model development of the District-Commune Two Tier local authority. It concludes by developing the steps for implementation of the district level on a gradual approach basis over the period 2008-2010.

Appendix 4 – Program on Fiscal Decentralization and Local Government Financial Management Schedule, 2006

Inserted on the following page.

2006 PROGRAM ON FISCAL DECENTRALIZATION AND LOCAL GOVERNMENT FINANCIAL MANAGEMENT

WEEK 1:

	Monday June 26	Tuesday June 27	Wednesday June 28	Thursday June 29	Friday June 30
9:00 - 10:30	Introduction Decentralization: An Overview	Sequencing Fiscal Decentralization Strategies	Workshop Presentation: Designing Fiscal Decentralization Strategies	Microeconomics for Revenue Analysis	Analytical Foundations for Tax Analysis 2
10:30 - 11:00	Coffee Break	Coffee Break		Coffee Break	Coffee Break
11:00 - 12:30	Decentralization: Theory and Practice	Institutional Options for Fiscal Decentralization		Analytical Foundations for Tax Analysis 1	User Charges: Theory and Practice
12:30 - 2:00	Lunch Break	Lunch Break	Lunch Break	Lunch Break	Lunch Break
2:00 - 3:30	Fiscal Decentralization: Allocating Expenditure Responsibilities	Workshop Preparation: Designing Fiscal Decentralization Strategies	Overview of Local Governments in North Carolina	Decentralizing Poverty Reduction: Rationale and Process	User Charges: Theory and Practice
3:30 - 4:00	Coffee Break		Coffee Break	Coffee Break	Coffee Break
4:00 - 5:30	Fiscal Decentralization: Allocating Revenue Responsibilities		Overview of Local Governments in North Carolina	Decentralization, Poverty and Social Mobility	Workshop Preparation Designing Water Charges
Evening					

2006 PROGRAM ON FISCAL DECENTRALIZATION AND LOCAL GOVERNMENT FINANCIAL MANAGEMENT

WEEK 2:

	Monday July 3	Tuesday July 4	Wednesday July 5	Thursday July 6	Friday July 7
9:00 - 10:30	Workshop Presentation Designing Water Charges	Workshop Presentation Designing Property Tax Reform in Africa	Taxing Businesses: The Single Business Permit in Kenya	Intergovernmental Transfers: Theory and Practice	Workshop Presentation: Designing Intergovernmental Transfers
10:30 - 11:00	Coffee Break	Coffee Break	Coffee Break	Coffee Break	
11:00 - 12:30	Property Taxation: Theory and Practice	Other Local Taxes: Income and Sales Taxes	Mobilizing Local Revenues Administrative Components	Designing Equalization: Theory and Practice	
12:30 - 2:00	Lunch Break		Lunch Break	Lunch Break	Lunch Break
2:00 - 3:30	Property Taxation: Policy and Administration	4th of July Celebration:	Workshop: Policy Options for Local Taxation	Workshop Preparation: Intergovernmental Transfer System	Intergovernmental Transfers and Poverty Alleviation
3:30 - 4:00	Coffee Break		Coffee Break		Coffee Break
4:00 - 5:30	Workshop Discussion Designing Property Tax Reform in Africa		Review: Problem Set & Assessment		Making Decentralization Work: Increasing Accountability & Transparency
Evening					

2006 PROGRAM ON FISCAL DECENTRALIZATION AND LOCAL GOVERNMENT FINANCIAL MANAGEMENT

WEEK 3:

	Monday July 10	Tuesday July 11	Wednesday July 12	Thursday July 13	Friday July 14
9:00 - 10:30	Performance Based Budgeting	Decentralizing Service Delivery: Privatization and Public-Private Partnership	External Aid and Decentralization	Fiscal Decentralization and Local Government Reforms Program Summary	Participant Assessment
10:30 - 11:00	Coffee Break	Coffee Break	Coffee Break	Coffee Break	
11:00 - 12:30	Bench Marking & Performance Indicators	Decentralizing Service Delivery: Privatization and Public-Private Partnership	Designing Decentralization Reform: Case Study: Nicaragua	Fiscal Decentralization and Local Government Reforms Program Summary	
12:30 - 2:00	Lunch Break	Lunch Break	Lunch Break	Lunch Break	Closing Lunch
2:00 - 3:30	Field Visit Town of Cary Revenue Structure Expenditure Responsibilities Citizen Participation	Capital Budgeting & Debt Finance	Local Development Funds: UNCDF Experience	Assessment Preparation	Free Time
3:30 - 4:00		Coffee Break	Coffee Break		
4:00 - 5:30		Capital Budgeting	Review: Assessment		
Evening					

Appendix 5 – Training Report ‘Designing a Fiscal Decentralization Strategy for Cambodia’

Inserted on the following page.



TRAINING REPORT

“DESIGNING A FISCAL DECENTRALIZATION STRATEGY FOR CAMBODIA”

**Economics and Finance Institute, Ministry of Economy and Finance
Phnom Penh, Cambodia
2-20 October 2006**

Course designed and implemented by the UNCDF/UNDP Fiscal Decentralization Support Programme (FDSP)

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“DESIGNING A FISCAL DECENTRALIZATION STRATEGY FOR CAMBODIA”
Economics and Finance Institute, Ministry of Economy and Finance
United Nations Capital Development Fund (UNCDF)
United Nations Development Programme (UNDP)

Phnom Penh, Cambodia
2-20 October 2006

Course Overview

Course Focus:

The “Designing a Fiscal Decentralization Strategy for Cambodia” course focused on the fundamentals of intergovernmental fiscal financial issues related to decentralization and deconcentration (D&D) in Cambodia. The course covered topics including the following: the theory and practice of fiscal decentralization, the allocation of expenditure functions, revenue assignment (tax sharing and tax assignment), central-local transfers, and subnational borrowing. In addition, specific issues of subnational budgeting and financial management, implementation strategies, and institutional options for Cambodia were covered. All lectures and workshop activities focused on applications for Cambodia.

Course Objectives:

The Fiscal Decentralization course was designed to provide MEF officials from various departments with the fundamental knowledge of intergovernmental fiscal policy which can be applied to the ongoing PFM (Program on Financial Management) and D&D (Deconcentration and Decentralization) reforms. The course was designed to enable MEF officials to better engage in the design, implementation and monitoring of the intergovernmental fiscal reforms which are aimed at improving the efficiency and accountability of public sector fiscal activities.

Course Faculty:

The course was designed and taught by Professor Roy Kelly, UNCDF/UNDP Fiscal Decentralization Advisor to the Ministry of Economy and Finance (MEF). Dr. Kelly is Professor of the Practice of Public Policy Studies, Sanford Institute of Public Policy, Duke University. Previously, he spent 19 years with Harvard University at the Kennedy School of Government, the Harvard Institute for International Development (HIID), and the Harvard International Tax Program teaching local government finance, tax analysis and project evaluation. Dr. Kelly has over 20 years of experience in teaching, designing and implementing reforms on fiscal decentralization, local government finance, revenue mobilization and property taxation in Asia, Africa, Latin America and Eastern Europe. He has served as resident advisor to the Ministry of Finance (Indonesia) from 1982-1988, Ministry of Local Government (Kenya) from 1998-2005 and with the Ministry of Economy and Finance (Cambodia) from 2005.

Scott Leiper, UNDP Senior Advisor to PLG/Seila, provided a guest lecture on the Cambodian Experience with coordinating donor funding to support the decentralization process.

Lim Chheng, UNDP National Local Government Advisor, provided logistical support and all translation service for the three-week course.

Course Participants:

The Fiscal Decentralization course was targeted for MEF officials who are and/or will increasingly be involved in the ongoing intergovernmental reforms aspects linked to the PFM and D&D reforms. Although the majority of participants were from the Department of Local Finance, the 33 registered course participants included representation from all other key MEF departments.

No.	Name	Department/Position
01	Mr. Liv Bunhay	Director of Local Finance Department
02	Mr. Chan Thy	Chief of Commune Sangkat Financial Management Office, Department of Local Finance
03	Mr. Hing Chanbora	Chief of Office, Department of Local Finance
04	Mr. Lay Veng Eang	Deputy of Commune Sangkat Financial Management Office, Department of Local Finance
05	Mr. Tann Lo	Deputy Chief Office, Department of Local Finance
06	Mr. Kean Leng	Deputy Chief Office, Department of Local Finance
07	Mr. Sreng Heang	Deputy Chief Office, Department of Local Finance
08	Ms. Khaan Pheakdey	Officer, Department of Local Finance
09	Ms. An Kimhor	Officer, Department of Local Finance
10	Mr. Chan Sopheak	Deputy Chief of Expenditure Office, National Treasury
11	Mr. Chum Kosal Mony	Deputy Chief of Accounting Office, National Treasury
12	Mr. Leng Vireak	Officer, Revenue Office of National Treasury
13	Ms. Ros Ariyan	Officer, Deposit Office of National Treasury
14	Mr. Hou Kunnavudh	Chief of Policy and Planning, Dept of Investment and Cooperation.
15	Mr. Ouk Pheareak	Deputy Chief of First Domestic Public Investment Office, Dept of Investment and Cooperation.
16	Mr. Tea Se	Chief of National Defense & Security Sector Budget Office, Budget Dept
17	Mr. Sin Noy	Chief of Economic Sector Budget Office, Budget Dept
18	Mr. Po Rithy	Chief of Administrative Sector Budget Office, Budget Dept
19	Mr. Vinh Rithipul	Chief of Social Affair Sector Budget Office, Budget Dept
20	Mr. Pen Vuthy	First Deputy Director of Non Tax Revenue Department
21	Mr. Thao Sokmony	Deputy Director of Non Tax Revenue Department
22	Mr. Ngin Rithy	Financial Controller Team Leader, Dept. of Financial Affair
23	Mr. Heng Sophal	Financial Controller Team Leader, Dept. of Financial Affair
24	Mr. Seang Sitha	Officer, Department of Policy and Public Finance
25	Mss. Sras Sopheakalyanika	Officer, Department of Policy and Public Finance
26	Mr. Mom Thano	State Property Department
27	Mr. Svay Kunnavuth	State Property Department
28	Mr. Long Seng	Chief of Tax Policy and Jurisdiction office, Tax Department
29	Ms. Pen Sopheakphea	Chief of Tax Policy and Jurisdiction office, Tax Department
30	Mr. Gnuon Sotheavy	Deputy Director of Phnom Penh Municipality Taxes Branch
31	Mr. Ky Bora	Deputy Chief of Monitoring and Information Office, Tax Dept
32	Mr. Eap Vuthy	Economics and Finance Institute
33	Mr. Kim San	Director of Monitoring and Evaluation Department, Seila Programme

Course Outline and Schedule

The Fiscal Decentralization course included class room lectures and discussion groups.¹ The course was held from 2-20 October. Class sessions were held in the mornings from 8:30 – 11:30, with a 30 minute coffee break from 10:00 – 10:30 am.

Week 1 focused on the following topics:

- Why Decentralization? Political, Administrative, and Fiscal Objectives
- What is a Systems Approach to Fiscal Decentralization?
- A Framework for Decentralization: Economic Theory and International Practice
- Understanding the Fundamentals of Fiscal Decentralization
- What are the Pillars of Fiscal Decentralization?
 - Allocating Expenditure Functions to Sub-national Levels
 - Allocating Locally Derived Revenues to Sub-national Levels
 - Designing the Intergovernmental Transfer System
 - Sub-national Borrowing Policy
- Learning from the Decentralization Experience in Cambodia (2002-2006)
- Understanding the D&D (Decentralization and Deconcentration) Policy Framework
- Allocating expenditure functions to sub-national levels: Theory, International Practice and Applications to Cambodia
- Allocating revenue instruments and revenues to subnational levels: Theory, International Practice and Applications to Cambodia

Week 2 focused on the following topics:

- Importance of Local Revenues for Decentralization
- What are the Revenue Policy Options for Sub-national Levels
- Policy and Administration Options for Property-related Taxation
- Fundamentals of Intergovernmental Transfer Design
- Learning from the Commune-Sangkat Transfer System Experience
- Sub-national Financial Alternatives for Cambodia: Options for Organic Law Consideration
- Designing a Budgeting and Financial Management System for Sub-national Levels

Week 3 focused on the following topics:

- Designing and Managing a Fiscal Decentralization Strategy
- Managing the Fiscal Decentralization Reforms in Cambodia
- Coordinating Donor Funding (SWAP Approach) for Decentralization: Cambodian Experience
- Course Summary and Examination

¹ Originally the course was to include a full 2 day field trip to meet with provincial and commune level officials to better understand the practice of fiscal decentralization in Cambodia. However, the field trip was not held for logistical reasons.

DESIGNING FISCAL DECENTRALIZATION STRATEGY FOR CAMBODIA

Ministry of Economy and Finance (2-20 October 2006)

Phnom Penh, Cambodia

WEEK 1:	Monday October 2	Tuesday October 3	Wednesday October 4	Thursday October 5	Friday October 6
8:30 - 10:00	Introduction Decentralization: An Overview	Decentralization in Cambodia: 2002-2005	Fiscal Decentralization: Theory and Practice	Fiscal Decentralization: Allocating Expenditure Responsibilities	Fiscal Decentralization: Allocating Revenue Responsibilities
10:00 - 10:30	Coffee Break	Coffee Break	Coffee Break	Coffee Break	Coffee Break
10:30 - 11:30	Decentralization: System Components	Decentralization in Cambodia: 2005-Onwards D&D Strategy	Fiscal Decentralization: Role of Local Development	Allocating Expenditure Responsibilities in Cambodia	Fiscal Decentralization: Allocating Revenue Responsibilities

WEEK 2:	Monday October 9	Tuesday October 10	Wednesday October 11	Thursday October 12	Friday October 13
8:30 - 10:00	Allocating Revenue Responsibilities in Cambodia	Property-related Taxation	Fiscal Decentralization: Intergovernmental Transfers	Sub-national Governance Administration: Draft Financial Provisions	Budgeting and Financial Management Framework for Sub-national Levels
10:00 - 10:30	Coffee Break	Coffee Break	Coffee Break	Coffee Break	Coffee Break
10:30 - 11:30	Allocating Revenue Responsibilities in Cambodia	Property-related Taxation Options for Cambodia	Intergovernmental Transfers in Cambodia	Sub-national Governance Administration: Draft Financial Provisions	Sub-national Budgeting Options for Cambodia

DESIGNING FISCAL DECENTRALIZATION STRATEGY FOR CAMBODIA

Ministry of Economy and Finance (2-20 October 2006)

Phnom Penh, Cambodia

WEEK 3:	Monday October 16	Tuesday October 17	Wednesday October 18	Thursday October 19	Friday October 20
8:30 - 10:00	Institutionalization Options for Fiscal Decentralization International Experience	Coordinating Donor Funding (SWAP Approach):	Course Summary and Review	Course Assessment Preparation (In-class)	Course Assessment
10:00 - 10:30	Coffee Break	Coffee Break	Coffee Break	Coffee Break	Coffee Break
10:30 - 11:30	Institutionalization Options for FD in Cambodia	Coordinating Donor Funding for Decentralization in Cambodia	Course Summary And Review	Course Assessment Preparation (In-class)	

Course Materials:

Powerpoint course materials were provided for the following topics:

1. FISCAL DECENTRALIZATION: AN OVERVIEW
2. DECENTRALIZATION EXPERIENCE IN CAMBODIA
3. DECENTRALIZATION: THEORY AND PRACTICE
4. DECENTRALIZATION: ALLOCATING EXPENDITURE RESPONSIBILITIES
5. DECENTRALIZATION: ALLOCATION REVENUE RESPONSIBILITIES
6. PROPERTY TAXATION
7. CENTRAL-LOCAL GRANTS
8. SUB-NATIONAL GOVERNANCE ADMINISTRATION: DRAFT FINANCIAL PROVISIONS
9. INSTITUTIONALIZING INTERGOVERNMENTAL FISCAL SYSTEMS: OPTIONS FOR CAMBODIA
10. SUB-NATIONAL BUDGETING OPTIONS FOR CAMBODIA
11. INTERNATIONAL DONOR FINANCE: OPTIONS FOR CAMBODIA
12. COURSE SUMMARY MATERIALS

Final Examination:

A final examination consisting of 20 questions was given to the participants to use to review the course material, discuss, and prepare answers. The exam, held on the final day, consisted of each participant writing short answers on 8 of the same questions chosen by the instructor.

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ការគ្រប់គ្រងហិរញ្ញវត្ថុសាធារណៈ នៃក្រសួងសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ

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<p>កម្មវិធីអភិវឌ្ឍបច្ចេកទេស និង វិជ្ជាជីវៈ ការរៀបចំយុទ្ធសាស្ត្រវិមជ្ឈការ សារពើពន្ធសម្រាប់ប្រទេសកម្ពុជា (Professional and Technical Development Program: Designing a Fiscal Decentralization Strategy for Cambodia)</p>	
<p>សេចក្តីផ្តើម</p>	<p>ក្នុងគោលដៅ រួមចំណែកក្នុងការកសាងសមត្ថភាពមន្ត្រីរាជការ នៃក្រសួងសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ សម្រាប់បម្រើដល់ការអនុវត្តកម្មវិធី កំណែទម្រង់ ការគ្រប់គ្រង ហិរញ្ញវត្ថុសាធារណៈ វិទ្យាស្ថានសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ បានរៀបចំវគ្គ បណ្តុះ បណ្តាលស្តីពី ការរៀបចំយុទ្ធសាស្ត្រវិមជ្ឈការសារពើពន្ធ សម្រាប់ប្រទេស កម្ពុជា (Designing a Fiscal Decentralization Strategy for Cambodia) ជូនមន្ត្រីរាជការ នៃក្រសួងសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ ។</p>
<p>កាលបរិច្ឆេទ</p>	<p>០២ ដល់ ២០ ខែ តុលា ឆ្នាំ ២០០៦</p>
<p>ទីកន្លែង</p>	<p>វិទ្យាស្ថានសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ នៃក្រសួងសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ</p>
<p>គោលដៅ</p>	<p>វគ្គបណ្តុះបណ្តាលនេះ រៀបចំឡើងក្នុងគោលបំណង ដើម្បីផ្តល់ជូនមន្ត្រីរាជការ នៃក្រសួងសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ ឱ្យយល់ដឹងអំពីមូលដ្ឋានគ្រឹះ នៃការគ្រប់គ្រង សារពើពន្ធ តាមប្រព័ន្ធវិមជ្ឈការ និង វិសហមជ្ឈការ ក្នុងបរិបទនៃប្រទេសកម្ពុជា ។ វគ្គបណ្តុះបណ្តាលនេះ នឹងរួមចំណែកពង្រឹងសមត្ថភាពមន្ត្រីរាជការក្រសួង ផ្នែក ការគ្រប់គ្រងហិរញ្ញវត្ថុមូលដ្ឋាន ការបែងចែក និង ការពង្រឹងវិន័យវិភាគ និង សារ ពើពន្ធ ក្នុងប្រព័ន្ធវិមជ្ឈការ និង វិសហមជ្ឈការ ដែលមានសារៈសំខាន់ចំពោះ កម្មវិធីកំណែទម្រង់ការគ្រប់គ្រងហិរញ្ញវត្ថុសាធារណៈ ។ មួយវិញទៀត វគ្គបណ្តុះ បណ្តាលនេះ នឹងផ្តល់ឱកាសជូនសិក្ខាកាម ក្នុងការដកស្រង់បទពិសោធន៍ និង ការអនុវត្តជាក់ស្តែង នៃការគ្រប់គ្រងសារពើពន្ធតាមប្រព័ន្ធវិមជ្ឈការនៅកម្ពុជា តាមរយៈការចុះធ្វើកម្មសិក្សា នៅតាមបណ្តាខេត្ត-ក្រុងមួយចំនួន ទៀតផង ។</p>
<p>សិក្ខាកាមចូលរួម</p>	<p>មន្ត្រីរាជការ (ចំនួន ៣២ នាក់) ដែលកំពុងបំពេញការងារ នៅតាម នាយកដ្ឋាន ពាក់ព័ន្ធ នៃក្រសួងសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ បានចូលសិក្សា និង ហ្វឹកហ្វឺននៅក្នុង វគ្គនេះ ។</p>
<p>មាតិកានៃការបណ្តុះបណ្តាល</p>	<ul style="list-style-type: none"> • Why Decentralization? Political, Administrative, and Fiscal Objectives • What is a Systems Approach to Fiscal Decentralization? • A Framework for Decentralization: Economic Theory and International Practice • Understanding the Fundamentals of Fiscal Decentralization

	<ul style="list-style-type: none"> • What are the Pillars of Fiscal Decentralization? • Learning from the Decentralization Experience in Cambodia (2002-2006) • Understanding the RGC D&D (Decentralization and Deconcentration) Policy Framework • Learning from the Commune-Sangkat Transfer System Experience • Designing and Managing a Fiscal Decentralization Strategy <p>Week 2 will focus on the following topics:</p> <ul style="list-style-type: none"> • Importance of Local Revenue Mobilization for Decentralization • What are the Revenue Policy Options for Subnational Levels • Policy and Administration Options for Property-related Taxation • Improving the Business Licenses/Patente • Workshop Discussion (Presentation) on Allocating Revenues in Cambodia • Fundamentals of Intergovernmental Transfer Design • Workshop Discussion (Presentation) on Intergovernmental Transfers in Cambodia <p>Week 3 will focus on the following topics:</p> <ul style="list-style-type: none"> • Designing a Budgeting and Financial Management System for Subnational Levels • Coordinating Donor Funding (SWAP Approach) for Decentralization: Application to Cambodia • Field Trip to Province: Decentralization in Practice <ul style="list-style-type: none"> - Briefing with Provincial Ex-Com support structure for communes - Briefing with Provincial Treasury - Briefing with Provincial Tax Department - Briefing with Commune Councils - Visit commune projects funded by CS Fund - Briefing with Commune Accountability Committee - Designing a Fiscal Decentralization Strategy for Cambodia
<p>ត្រូវឧទ្ទេសនាម</p>	<p>បណ្ឌិត Roy Kelly</p>

Source: <http://www.mef.gov.kh/documents/Training%20Courses/Training%20Course.htm>



ព្រះរាជាណាចក្រកម្ពុជា
ជាតិ សាសនា ព្រះមហាក្សត្រ
KINGDOM OF CAMBODIA
Nation Religion King

ក្រសួងសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ
MINISTRY OF ECONOMY AND FINANCE

N°.....MEF/.....

Phnom Penh, November 15, 2006

Prof. **Roy Kelly**
Fiscal Decentralization Adviser
United Nations for Development Program

Dear Prof. **Roy Kelly**,

On behalf of the Ministry of Economy and Finance, Cambodia, I would like to thank you for your assistance to deliver a training course on Designing a Fiscal Decentralization Strategy for Cambodia, which was held from 02-20 October 2006 at the Economics and Finance Institute (EFI), for the officials of the Ministry of Economy and Finance.

Dr. Hean Sahib, Deputy Secretary General of the Ministry of Economy and Finance and Mr. Seng Sreng, Director of EFI has reported to me that the 31 mid-level officials as well as high-level officials are totally happy with your caliber training that emphasized both on the theoretical as well as practical policy applications of Fiscal Decentralization of Cambodia.

As you know, the Ministry of Economy and Finance has implemented the Public Financial Management Reform Program (PFMRP). I therefore would be highly appreciated if you could help EFI to deliver other training courses that is highly related to the PFMRP to help strengthen our mid-level official capacity of the Ministry of Economy and Finance and thereby contributing to the success of the implementation of the PFM reform program.

I have appointed Dr. Hean Sahib, Deputy Secretary General of the Ministry of Economy and Finance and Mr. Seng Sreng, Director of the Economics and Finance Institute, Ministry of Economy and Finance to discuss with you for the priority training needs of our Ministry.

Thank you again for an excellent training program delivered for our government officials. Your presence at our institute helped reinforced the quality of training at the Ministry of Economy and Finance. ✓

Yours sincerely,

Keat Chhon
Sr. Minister
Minister of Economy and Finance

FISCAL DECENTRALIZATION: An Overview

Prof. Roy Kelly, PhD

UNCDF/UNDP Fiscal Decentralization Advisor
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Designing a Fiscal Decentralization Strategy for Cambodia
Ministry of Economy and Finance
Royal Government of Cambodia
(2 – 20 October 2006)

1

DECENTRALIZATION: AN INTERNATIONAL PHENOMENON

- ECONOMIC AND SOCIAL DEVELOPMENT
- IMPROVE SERVICE DELIVERY EFFICIENCY AND ACCOUNTABILITY
- GOVERNMENT REENGINEERING, PRIVATIZATION, AND DECENTRALIZATION
- DECENTRALIZATION: REALLOCATING FUNCTIONS AND FINANCES ACROSS GOVERNMENT ADMINISTRATION LEVELS

**DECENTRALIZATION IS A PROCESS
A MEANS -- NOT -- THE END**

2

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DECENTRALIZATION: AN ONGOING PHENOMENON

- IN OVER 85 COUNTRIES
- POLITICAL AND ECONOMIC RATIONALE
- VARIETY OF COMPONENTS & APPROACHES/SEQUENCING
- POLITICAL, FISCAL AND ADMINISTRATIVE COMPONENTS

Decentralization: Ultimately a Political Decision

BUT Success depends on Comprehensive Approach of
Political, Administrative and Fiscal Aspects

3

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What are the Political Aspects?

Involves shifting power to subnational levels of government

WHY? Two views

1. To “bring government closer to the people” to enhance responsiveness, accountability and transparency
2. To extend ruling party / central government dominance

Some examples:

- Nigeria: military regime using local governments to undermine state-based ethnic challenges
- Uganda: Foundation for ruling party control (resistance councils became local councils)
- Indonesia and Pakistan: Bypassed provinces to break power of the provinces

Other Examples?

Political Motivation often leads to establishing elected local governments with inadequate empowering through administrative and fiscal decentralization (Romeo, 2003)

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DECENTRALIZATION IN PRACTICE

GREAT DIVERSITY:

1. Indonesia & Pakistan: “Big Bang” Approach
2. Uganda: “Systematic Model” Approach
3. Kenya: “Incremental Stealth” Approach
4. Latin America: “Democratization--Revenue First” Approach
5. Transitional Countries: “Market & Democratic Transition--Expenditure First” Approach
6. Developed Countries: “Efficiency Improvement—Post Welfare State Era” Approach

5

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DECENTRALIZATION: AN EMERGING ASIAN PHENOMENON

- **Fast Starters** (Indonesia, Philippines, and Pakistan)
 - Political changes, with substantial fiscal sharing**
 - 1986/1991 “People Power” in the Philippines
 - 1997/2001 “Big Bang” in Indonesia and Pakistan
- **Incrementalists** (China, Vietnam)
 - Modest political changes, focus on fiscal and administrative reforms**
- **Cautious Movers** (Thailand, Cambodia)
 - Thailand: 1997 Constitution, decentralization policy
 - Cambodia: 1993 Constitution, elected commune level in 2002, now drafting organic law with new district and provincial levels.

World Bank, [East Asia Decentralizes](#), (2005)

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What is Decentralization?

Deconcentration: redistribution of decisionmaking among different administrative levels within the central government

Delegation: transfer of responsibilities and power from the central government to semi-autonomous organizations not wholly controlled by the central government

Devolution: transfer of responsibilities and powers from the central government to autonomous local government administrations

Privatization: transfer of responsibilities and powers to the private sector/communities/NGOS.

Source: Rondinelli, 1983

BE CLEAR ON WHAT WE MEAN
(What is the Definition?)

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What is definition of Decentralization and Deconcentration (D&D) in Cambodia?

Decentralization: **assignment** of political and administrative authority to the commune level

Deconcentration: **delegation** of administrative responsibilities, decisionmaking and authority from central ministries to subnational provincial departments and/or district offices

“Deconcentration of state functions to provincial governors and related reforms focusing on the province and the district as sub-national levels for budgeting, planning, finance and administration of development has made **very little progress to date**”

Source: Cambodia at the Crossroads: Strengthening Accountability to Reduce Poverty, (World Bank, 2004), p. 51

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WHY REFORM PUBLIC SECTOR THROUGH DECENTRALIZATION?

- **Improves Efficiency of Public Services**
 - Links mix and level of services to the local citizen demand
- **Improves Political and Financial Accountability**
 - Brings Government 'Closer to the People'
- **Improves Effectiveness**
 - Mobilizes citizen participation, innovation and ownership ('social capital')
 - Allows competition in public services ("best practices")

Effective decentralization can assist in achieving the **PFM Objectives** of improving the **credibility** and **accountability** of public sector decisions on planning, budget execution, monitoring

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DECENTRALIZATION DESIGN ISSUES

Complicated Process

- Multiple Stakeholders
- Multidisciplinary (political, fiscal, institutional)
- Multiyear (time & institutional dimensions)

Potential Problems?

- Macroeconomic instability
- Increased regional inequality and conflicts
- Declining service levels
- Increased Corruption

DESIGN AND IMPLEMENTATION STRATEGY IS CRITICAL

STRATEGY MUST BE COUNTRY SPECIFIC

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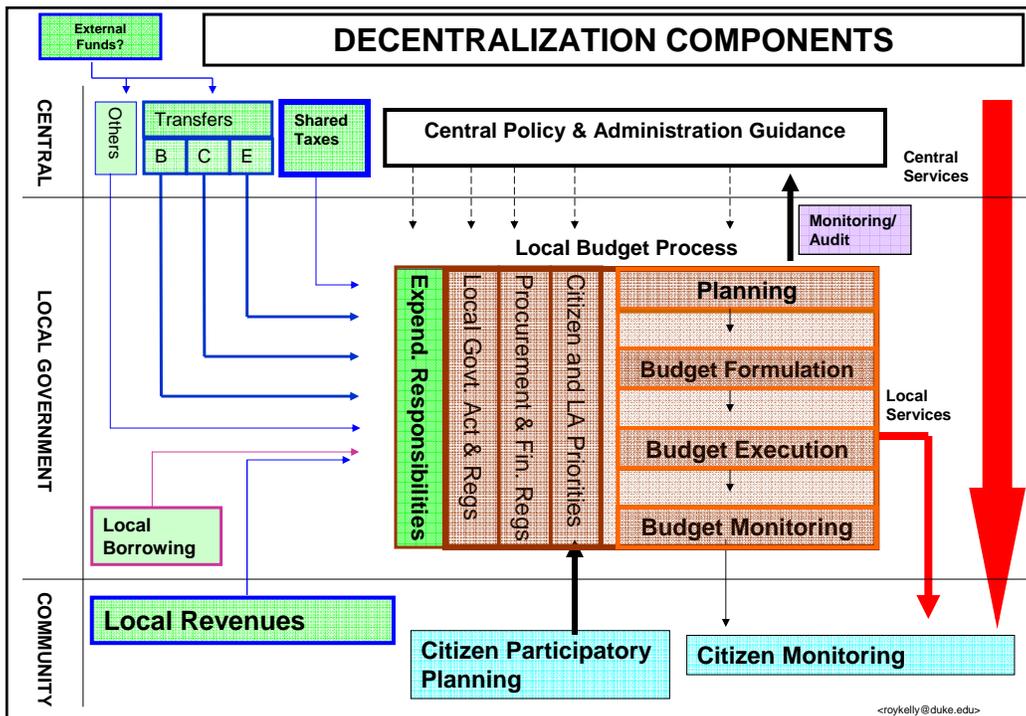
PILLARS OF FISCAL DECENTRALIZATION

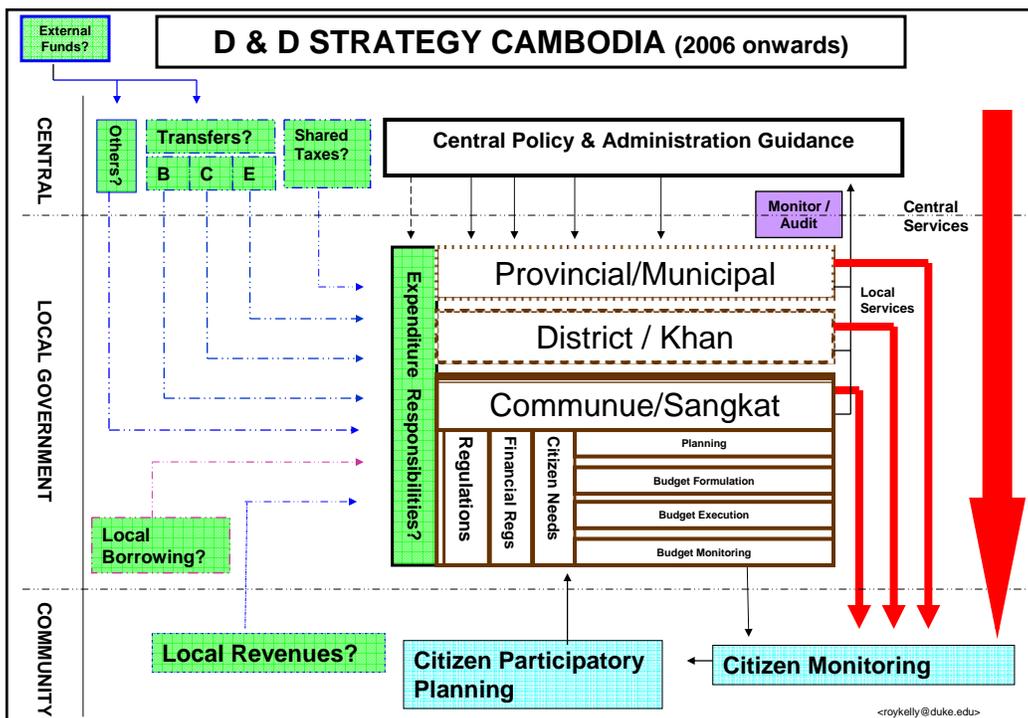
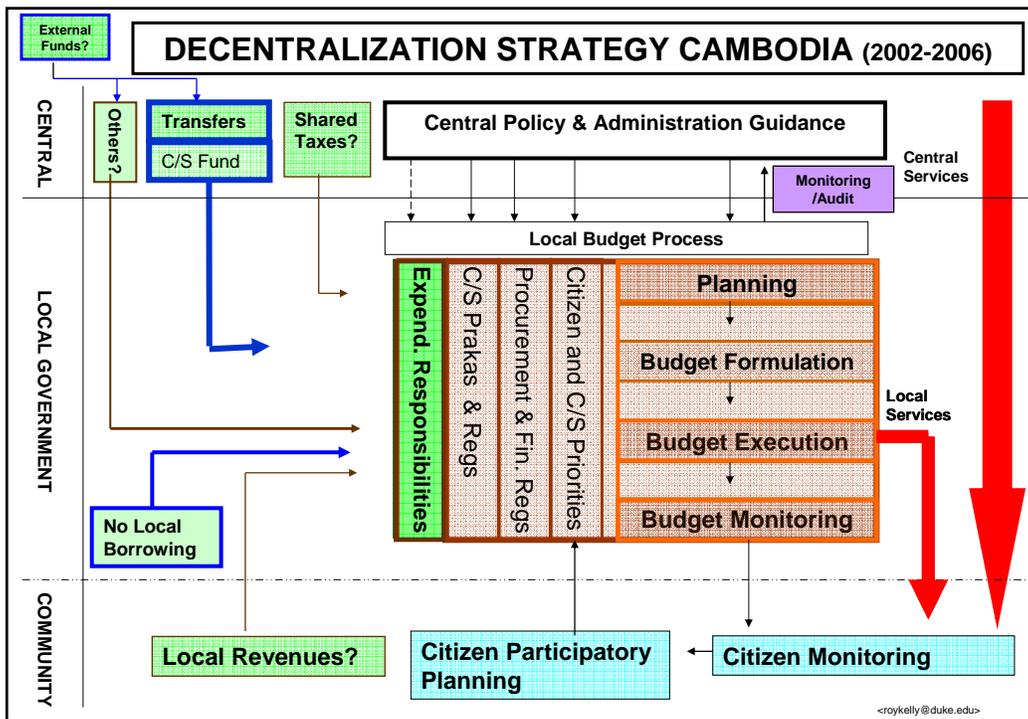
- Rationalize Expenditure Responsibilities
- Rationalize Revenue Sources
- Structure Intergovernmental Transfers
- Structure Local Level Borrowing/Debt

BUT within the context of:

- Political Will
- Legal Framework
- Institutional Structures
- Systems and Procedures
- Central / Local Capacity
- Central, Local and Community Oversight

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WHAT ARE MEF CONCERNS?

- **Allocation of expenditure decisions**
 - Need to shift budgeting decisions across levels of government authorities
 - Need to shift fund flows, require system of block and categorical transfers
 - Need to shift government assets across levels
 - Need subnational budgeting, accounting and financial systems and procedures
- **Allocation of Revenue Decisions**
 - Need funds to match expenditures, thus need to reallocate revenues through mixture of transfers, shared taxes, locally derived revenues
 - Need locally derived revenues to improve efficiency and accountability
- **Intergovernmental Transfers**
 - Need system of block and categorical grants, linked to expenditure responsibilities
 - Need system of managing intergovernmental fiscal system (Intergovernmental Fiscal Committee / Fund Boards)
- **Subnational Borrowing**
 - Need policy guidelines and regulations for subnational borrowing

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CONDITIONS FOR EFFECTIVE DECENTRALIZATION

(Rondenelli, 1981)

POLITICAL AND ADMINISTRATIVE CONDITIONS

- Strong political commitment and central support
- Acceptance for planning and management by organizations outside direct central government control
- Strong line agency support
- Strong administrative and technical capacity to carry out national development functions and support local efforts
- Effective channels of political participation to allow local citizens to express their needs and demands

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ORGANIZATIONAL FACTORS

- Appropriate allocation of planning and administrative functions among levels of government
- Definitive decentralization laws, regulations, and directives concerning the relationships among levels
- Flexible arrangements (based on performance criteria) for reallocating functions as local government capacity and resources develop
- Planning and management procedures for eliciting local participation in project development and implementation
- Communication linkages among local govt agencies/units
- Diverse supporting organizations that complement local government and planning organizations

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BEHAVIORAL AND PSYCHOLOGICAL CONDITIONS

- Changes in central and lower level officials from a top-down approach to a participatory relationship in development
- Effective means to overcome resistance of local elites and traditional leaders
- Creation of minimum level of trust between citizens and government
- Maintenance of strong leadership within local government units to facilitate exchange between central and local levels

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RESOURCE CONDITIONS

- Transfer of sufficient authority to mobilize financial resources
- Adequate physical infrastructure, transportation and communication linkages to facilitate resource mobilization
- Articulated and integrated settlement pattern to promote economic, social, political and administrative interaction among the local government units

Do these conditions exist in Cambodia?

“We are Building the Ship while Sailing” (Quote from Indonesia ‘Big Bang’)

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KEY ISSUES:

Need to establish:

- Link between demand and supply of services
- Accountable and responsive government
- Clear expenditure and revenue responsibilities with autonomy and capacity to respond
- Proper incentives (e.g., hard budget constraint)
- Supportive external environment (e.g., central government, legal structure)
- Process to dynamically coordinate, monitor and adjust the reform

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DECENTRALIZATION IN CAMBODIA: Decentralization and Deconcentration (D&D) Strategy Components

By

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Designing a Fiscal Decentralization Strategy for Cambodia
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1

Cambodia: Basic Parameters

- **Population: 13.4 million**
 - **Area : 181,035 sq. kilometers**
 - **Constitutional Monarchy**
 - **Parliamentary Government**
 - **Unitary Structure**
-
- **Subnational Structure:**
 - **24 Provinces (including 4 Municipalities)**
 - **185 Districts**
 - **1,621 Communes (plus “Sangkats” in Municipalities)**

The average Commune pop. size = 7,600 inhabitants

2

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Decentralization Progress to Date

- Commune elections held in Feb 2002
- Commune/Sangkat Administration Law and related regulations established framework for expenditure and revenue responsibilities, Commune/Sangkat Fund, ...
- Planning, budgeting, financial management systems developed and tested through SEILA mechanism
- Participatory decision making, leading to implementation of development projects (approx. \$8 million annually)

Focused on Commune/Sangkat Level

3

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Decentralization Reforms are New

- In February 2002, **Commune Councils** were elected in all 1,621 Communes.
- The **Law on Commune/Sangkat Administration** provides the basic legal framework and assigns both **administrative** and **developmental** responsibilities.
- Communes authorities are meant to perform both :
 - **Own functions**, articulating policies and programs on behalf of a local citizens and funding them with own resources
 - **Agency functions**, implementing policies and programs defined and funded by higher-level authorities

4

Romeo, 2004

- Communes have their own **financial resources, budgets and assets**.
 - They may raise **own-source revenue** from taxes, fees and service charges**
 - They may receive a share of national revenue (**revenue-sharing**)
 - They have right to **general-purpose fiscal transfers** They must be compensated for the cost of functions they perform on behalf of the central administration (**no un-funded mandates**)

** Own source revenues to be determined under separate law: **Delayed**

5
Romeo, 2004

Commune Experience (2002-2005)

- Communes' **own responsibilities** for local development are currently broadly defined and not yet specific or mandatory.

"To promote local economic and social development and the general welfare of the local population"

- **Inter-governmental arrangements** to reassign and/or share with Communes responsibilities for delivery of most basic services remain to be developed.

6
Romeo, 2004

Commune Experience (2002-2005)

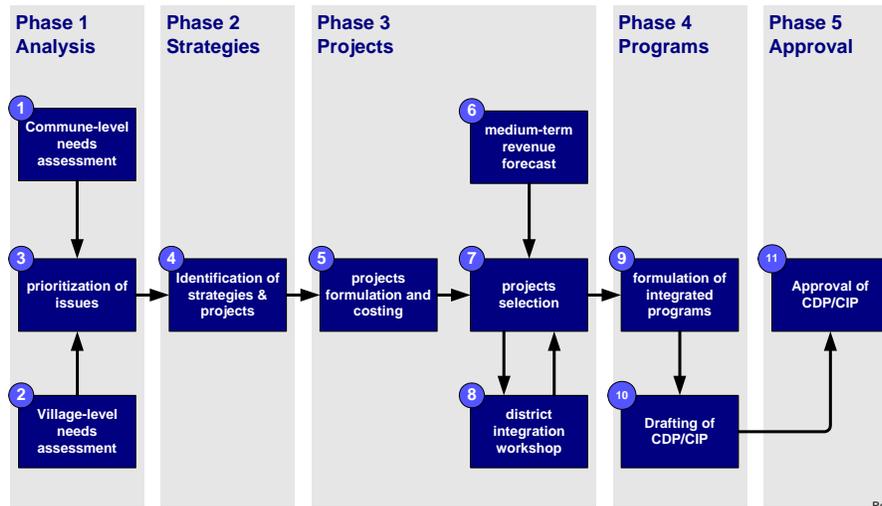
- Nevertheless **Communes have started** to address local development issues and, through the mandatory Commune Development Planning (CDP) process, they have:
 - **Influenced** the resource allocation managed by provincial departments, NGOs and donor-funded programs;
 - **Allocated** their own resources for development spending (essentially Commune Sangkat Fund transfers) to local priorities
 - **Implemented** local development projects worth about **\$32 million from 2002-2006**

7
Romeo, 2004

Institutional Innovations : Planning

Commune Development Planning Process

As mandated by the Law, regulations were issued to guide the **Commune Development Planning (CDP)** and Budgeting process. The CDP involves five phases and 11 steps.



Romeo, 2004

Institutional Innovations : Financing

Commune/Sangkat Fund

The Commune/Sangkat Fund (CSF) was established by the **Law on Commune/Sangkat Administration** as mechanism for **general-purpose fiscal transfers**

The **long term** objectives of the CSF are to:

- **Devolve** resources to match local responsibilities
- **Equalize** the fiscal position of different jurisdictions
- **Provide incentives** to LG performance in public expenditure management

The **short term** objectives of the CSF are to:

- Provide all CS with **a minimum of freely programmable resources** to support introduction of autonomous **local-level process of planning and budgeting** and thus...
- Break the **vicious circle of low capacity/low resources**, before substantial responsibilities and resources can actually be devolved

9

Romeo, 2004

Commune/Sangkat Fund Structure

- **Capitalization:** fixed percent of recurrent national revenues
 - Annual increasing: 2.52% – 2.56% (from 2005-2007)
 - In 2007, approx. \$R 89 billion, US\$21.7 million
- **Structure:** 1/3 for Administration and 2/3 for Development
- **Formula Allocation:**
 - Administration based on number of councilors
 - Development based on fixed share, population and poverty
- **Oversight:** Established a CS Fund Board (but never operationalized)

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Lessons learned...

- Providing newly elected authorities with a minimum of freely programmable resources is critical to allow **learning-by-doing** in basic local-level **public expenditure management**
- Specifying comprehensive local-level **planning and budgeting procedures** provides a **national framework** for a coordinated effort of local capacity building, even if allowance must be made for **great variations** in adoption and quality of the planning process across jurisdictions and in time.
- At the initial stage of the reforms, a critical condition of success is the **investment of the State** in dedicated, deconcentrated (provincial) structures of **support and supervision** of the emerging LG sector. In Cambodia the model provided in this respect by the Seila program with external funding needs now to be fully institutionalized and sustained.

11
Romeo, 2004

...Lessons learned (continued)

- A statutory CDP planning process helps to align Commune-level choices and resources allocation with **broad-based local priorities**
- Genuine people's participation in local public decision making, depends on the **effective articulation** of their **political representation** in the Councils with **village-based representation** of community interests well beyond assembly-style meetings
- Commune-level **procurement is potentially effective** in reducing costs of infrastructure and services, but the realization of this potential is dependent on the development of an **effective system** of technical supervision and contracts administration (currently provided through the Seila/PLG structure)

12
Romeo, 2004

The Way Forward 1

- **Political dimensions**
 - The relation between **Commune authorities and village-level community organizations** must be strengthened to allow for more structured/effective people's participation in local public choices, while reaffirming the primary responsibility of the Councils for such choices.
- **Administrative dimensions**
 - Responsibilities for a range of developmental and administrative services must be **reassigned and/or shared**. In time these should include **basic services** in the sectors most directly relevant to poverty alleviation (Education, Health, Rural Development and Agriculture)
 - Sustainable **provincial structures and systems**, must be created to provide **support** (facilitation and technical assistance services) and **supervision** (legality controls and performance monitoring) to Commune authorities.

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Romeo, 2004

The Way Forward 2

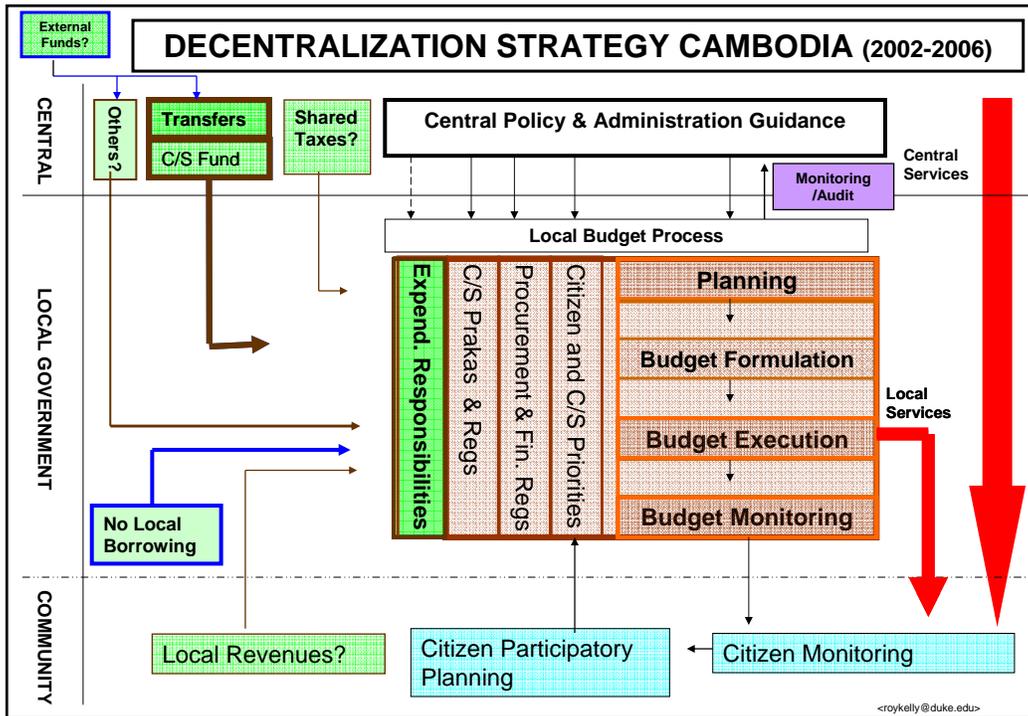
- **Fiscal dimensions**
 - Central and external commitment to a gradually **increasing level of fiscal transfers** through the CSF must be maintained
 - **Own-source revenue instruments** must be developed, including reassignment and sharing of provincial taxes and fees and the development of a Commune Services Levy

14
Romeo, 2004

Summary: Decentralization Reforms (2002-2006)
Focus on Communes/Sangkats

- **Expenditure Responsibilities:** General developmental, limited, not specific, but with assigned agency functions for civil registration
- **Revenue Responsibilities:** Assigned in law, but not in practice. Led to system of “informal fees”, often maintained semi-formally
- **Intergovernmental Transfers:** C/S Fund established, providing limited administration and development block grant funds
- **Borrowing:** Prohibited

Limited, Incremental Decentralization
First Priority: Political; **Second Priority:** Administration



Now Broadening the Public Sector Reform to Both Decentralization and Deconcentration (D&D)

- Strategic Framework for Decentralization and De-concentration (D&D) Reforms issued in June 2005
- D&D strategic objective to strengthen democratic governance and improved service delivery in order to enhance efficiency, accountability and transparency.
- D&D to reallocate decision-making authority, responsibilities and accountability to Provincial/Municipal (PM), district/Khan (DK) and Commune/Sangkat (CS) levels
- The Constitution (Chap 13, Art. 146) provides for an 'Organic Law' to manage the subnational levels of government (provinces/municipalities, district/khan and commune/sangkats), (p.4)
- Organic Law now under preparation to codify the RGC's policy on Decentralization and Deconcentration

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D&D Strategic Objectives (p.5)

- To Strengthen / Expand Local Democracy
- To Promote Local Development and Reduce Poverty

D&D Design Principles (p.5-6)

- Democratic Representation
- Citizen Participation
- Public Sector Accountability
- Effectiveness
- Poverty Reduction

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D&D Strategic Framework Priorities

Dual Priority to be given to: (p.7)

- **Restructuring provincial/municipal (PM) and district/khan (DK) institutional structures** through establishing 'unified' and 'accountable' administrations.
- **Strengthening C/S administration** by increasing responsibilities and resources to deliver services and to strengthen PM and DK levels to provide support to C/S.

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Provincial and Municipal Structures

- Governing Board to comprise appointed Governor, Deputy Governors, and other
- PM and DK councils to be established by indirect elections (*five year mandate*)
- 'Unified budget', which are entitled to part or whole of collected revenues within jurisdiction and transfers from national budget. The size of budget will correspond with service delivery responsibilities
- Responsible to manage development activities and deliver public services and infrastructure as specified in organic law and national policy.
- Control of manpower resources

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Phnom Penh Structure

- Unified Administration, established under separate law
- Governing Board to comprise appointed Governor, Deputy Governors, and other
- Khans to be headed by appointed governor, with indirectly elected council (*5-yr mandate*).
- Unified budget, entitled to part or whole of collected revenues within jurisdiction and transfers from national budget. Size of budget will correspond with service delivery responsibilities
- Control of manpower resources

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Rural District/Khans

- Unified Administration, similar to PM level.
- District/Khans to be headed by appointed governor, supported by a Board of Governor, with indirectly elected council (*5-yr mandate*).
- Responsible for security, public order and development management of the DK as well as some specific responsibilities for service delivery and development management.
- At initial stage of reform, the DK will not have a budget, its expenses will be subsumed under the PM budget and staff management.

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Urban Areas

- Unified Administration, similar with other DK, but with 'status of legal entity'.
- Management system of exiting commune/sangkats in urban areas outside of Phnom Penh will be strengthened with additional structures, staff, capacity and resources.
- Perform functions dealing with urban areas.

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Commune/Sangkats

- Similar to current C/S structure
- More duties to provide public services to be transferred to CS level
- Financial resources will be developed based on responsibilities, including increase in CS Fund, development of own source revenues and share of revenues collected.

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3-Year Priorities under D&D (p.14)

- Enact **organic law** and revise existing legal instruments
- Establish PM and DK **indirectly-elected councils**
- Establish **unified administration** at PM and DK levels
- Establish **personnel management system** at P/M and D/K levels covering all sectoral departments and agencies
- Establish **unified planning and budgeting** at PM level.
- **Mobilize and allocate foreign and domestic resources** for development and capacity building at three levels of decentralized government.

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Approach for Development Partners? (p.16-17)

- To follow **RGC D&D Priorities**
- To follow a **Program approach**, with D&D Forum established linking RGC and Development Partners to improve coordination, support, and monitoring of technical and financial assistance.
- To follow a **Basket Fund approach**, but with option for parallel support if necessary with RGC approval

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Financial Aspects of D&D Strategic Framework

- **User charges** will be permitted on services delivered by all three decentralized government levels
- **Own source revenues** will be granted to all three decentralized government levels through a 'closed list'
- **Collection authority will be granted to each level** of government
- **Intergovernmental transfers will be through transparent formula basis**, cognizant of fiscal equalization, vertical compensation, revenue collection incentive and improvement in expenditure management.
- **Financial management systems will be reformed** at all government levels to ensure accountability.

(p. 12-13)

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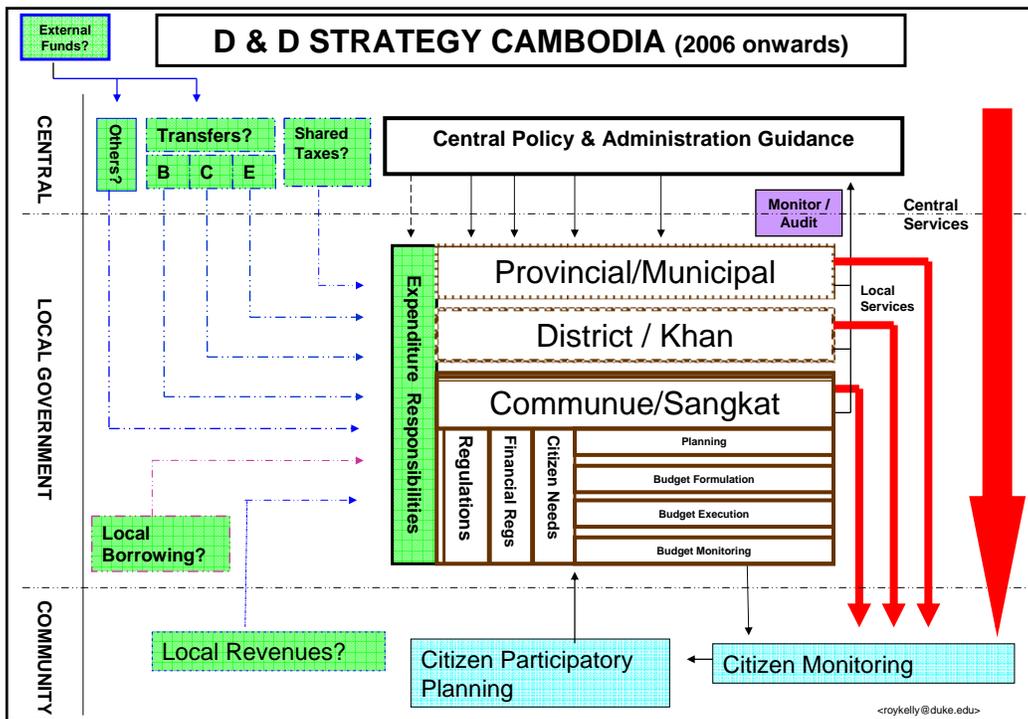
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Fiscal Implications of D&D (p. 12-13)

- Central government budget allocations to be reallocated to PM, DK and CS level—in line with transfer of expenditure responsibilities and staff management
- Intergovernmental Revenue Transfer System to be established/expanded to PM, DK and CS levels
- External and internal resource flows to be linked across government levels.
- Own-source revenues to be assigned to PM, DK and CS government levels through a closed list approach.
- Tax (revenue) administration system options to be developed for PM, DK and CS levels
- Budgeting and financial management systems to be improved to ensure accountability and transparency

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Summary: Decentralization Reforms (2007- onwards)
Broaden Focus to Provinces, Districts and Communes/Sangkat

- **Expenditure Responsibilities:** General developmental, limited, with specificity overtime (delegated and own functions)
- **Revenue Responsibilities:** To be assigned in law under 'closed list system' (shared and own source)
- **Intergovernmental Transfers:** To be expanded to include all levels, a mixture of block and categorical grants
- **Borrowing:** Limited, with strict MEF approval needed

Expanded, Incremental Decentralization and Deconcentration
Priority: Should be Comprehensive to include
Political, Administrative and Fiscal

Indicative D&D Implementation Plan

D&D Implementation Plan has four phases:

1. **Preparatory Phase** (2006)
2. **Initial Implementation Phase** (2007-2009)
3. **Transition Phase** (2010-2012)
4. **Transformation Phase** (2013-onwards)

Source: HE Sar Kheng, 8th Consultative Group Meeting of Government-Donors, 2-3 March 2006.

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Indicative D&D Implementation Plan

ACTIVITIES	2006	2007-2009				2010-2012				2013-Onwards								
Preparatory Phase																		
Organic Law Passed	XXXX																	
Initial Phase																		
Establish Implementation Authority		X	X	X	X													
Establish basic structures, procedures and systems				X	X	X	X											
Transition Phase																		
Restructure basic national and sub-national functions, systems, finance, structures, and policy								X	X	X	X	X	X	X				
Transformation Phase																		
Further transformation into Sustainable democratic development												X	X	X	X	X	X	X

Phase 1: Preparatory Phase (2006)

- Adoption of Organic Law

Phase 2: Initial Phase (2007-2009)

- Establish Implementation Authority
 - Oversee the implementation of the organic law
 - Oversee the implementation of the Democratic Development Policy
- Establish basic structures, procedures and systems necessary to underpin subsequent implementation process

Source: HE Sar Kheng, 8th Consultative Group Meeting of Government-Donors, 2-3 March 2006.

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Phase 3: Transition Phase (2010-2012)

- Restructure basic national and sub-national functions, systems, finance, structures, and policy

Phase 4: Transformation Phase (2012 – Forward)

- Further transformation into sustainable democratic development

Source: HE Sar Kheng, 8th Consultative Group Meeting of Government-Donors, 2-3 March 2006,

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What are the MEF Responsibilities under D&D?

- Develop a Fiscal Decentralization Strategy
- Improve Legal Framework and procedures for Sub national Financial systems (Provincial/Municipal, District/Khan and Commune/Sangkat)
- Strengthen MEF Capacity for Steering Intergovernmental Fiscal Reforms and Overseeing Sub-national Government

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Next Steps for MEF

- Actively participate in policy discussions and development of organic law
- Develop policy position on key “Pillars of Fiscal Decentralization”
 - Expenditure Allocations across Levels of Government
 - Revenue Allocation Options for Subnational Government**
 - Structuring Intergovernmental Transfers for D&D**
 - Subnational Borrowing Alternatives for Local Governments**
- Strengthen budgeting and financial management systems for all levels of subnational governments**

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DECENTRALIZATION: THEORY AND PRACTICE

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Designing a Fiscal Decentralization Strategy for Cambodia

Ministry of Economy and Finance
Royal Government of Cambodia
(2 – 20 October 2006)

1

DECENTRALIZATION TYPOLOGY

SPATIAL DECENTRALIZATION: Diffusing urban population and activities away from large agglomerations

MARKET DECENTRALIZATION (Privatization): Shifting from government to market provision

POLITICAL DECENTRALIZATION: Shifting political power to lower levels of government

ADMINISTRATIVE DECENTRALIZATION:

“**Transfer of responsibility for planning, management, and the raising and allocation of resources from the central government** to its agencies to field units of government agencies, subordinate units or levels of government, semi-autonomous public authorities or corporations area-wide, regional or functional authorities, nongovernmental private or voluntary organizations.” (Rondinelli and Nellis, 1986, p.5)

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Administrative Decentralization

Deconcentration: redistribution of decisionmaking among different administrative levels within the central government

Delegation: transfer of responsibilities and power from the central government to semi-autonomous organizations not wholly controlled by the central government

Devolution: transfer of responsibilities and powers from the central government to autonomous local government administrations

Privatization: transfer of responsibilities and powers to the private sector/communities/NGOS.

Source: Rondinelli, 1983

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What is definition of Decentralization and Deconcentration (D&D) in Cambodia?

Decentralization: **assignment** of political and administrative authority to the commune level

Deconcentration: **delegation** of administrative responsibilities, decisionmaking and authority from central ministries to subnational provincial departments and/or district offices

Source: Cambodia at the Crossroads: Strengthening Accountability to Reduce Poverty, (World Bank, 2004), p. 51

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DECENTRALIZATION: Allocating Functions

What is the Role of Government?

- Legal Framework
- Political and Administrative Process (Governance)
- Public Finance

Three Functions of Government (Musgrave, 1959)

- **Stabilization**
- **Distribution**
- **Allocation**

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STABILIZATION

Stabilize the economy at high levels of output and employment without creating excessive pressure on inflation.

Policy Instruments: monetary and fiscal instruments

Level of Government: Central Government

Why?

- (1) Requires the creation of money. Incentive for local government to print money, creating massive inflationary pressure.
- (2) Countercyclical budgetary measures are difficult for local government because of the “openness” of their economies.

But: Regional government sector can impact the aggregate demand. Regional government surpluses may offset national level deficits.

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DISTRIBUTION

Equalize income between regions and people. Establish the “safety-net”.

Policy Instruments: Transfer Programs

Level of Government: Central Government

Why?

(1) Due to extreme mobility of population and capital as a result of “openness of local government economies”, dramatic income redistribution programs would provide incentives for higher income households to migrate out and lower-income households to migrate in.

But: Funding from the central government but administration from the regional/local governments.

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ALLOCATION

Provide certain public goods and create the right regulations and incentives to allow the private sector to allocate resources in a non-distortionary manner.

Policy Instruments: Production & Provision(public/private)

Level of Government: Central and Local Government

Why?

- (1) Due to “Market Failures”, both central and local governments should be involved depending on the “Local” or “central” nature of the public good. (eg, natural monopolies, public goods and externalities).
- (2) Local public good provision by local government will increase national welfare, assuming no externalities.

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Which Government Level should do What? FISCAL FEDERALISM : BASIC MODEL

A. STABILIZATION Centralized

- Monetary policy must be national
- Local economies are highly open
- Local fiscal behavior is cyclical
- Local deficit financing undesirable

B. DISTRIBUTION Centralized

- Mobility limits local redistribution
- Inter-local resource disparities

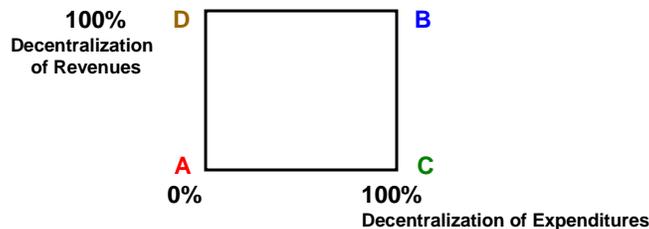
C. ALLOCATION Decentralized

- Demand non-uniform across localities
- Decisions tied to resource costs
- Greater experimentation
- “Voting with the Feet” (Tiebout 1956)

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FISCAL DECENTRALIZATION MODELS



Model Description

- A** Complete Centralization
- B** Complete Decentralization
- C** Centralized Revenues and Decentralized Expenditures
- D** Decentralized Revenues and Centralized Expenditures

Model	Stabilization	Distribution	Allocation
A	+	+	?
B	-	-	?
C	+ (p)	+ (p)	+
D	-	- (p)	-

DIVERSITY IN THE REAL WORLD

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INTERGOVERNMENT FINANCE IN PRACTICE

GREAT **DIVERSITY** IN FISCAL STRUCTURE:

1. Number of levels of Government
2. Constitutional / Legal Relationships
3. Degree of Political Legitimacy
4. Autonomy in Raising Revenue
5. Autonomy in Expenditure Decisions
6. Local Expenditure Needs
7. Local Fiscal Capacity
8. Intergovernmental Fiscal Flows

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PILLARS OF FISCAL DECENTRALIZATION

- Allocating Expenditure Responsibility
 - Allocating Revenue Sources
 - Designing Intergovernmental Transfers
 - Structuring Local Borrowing / Debt
-

- Financial Management
- Legal Structure

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Linkages between Decentralization and Local Development

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Decentralization and Deconcentration (D&D)

- Strategic Framework for Decentralization and Deconcentration (D&D) Reforms (2005):
- D&D strategic objectives (“**democratic development**”)
 - To strengthen **local democracy** and
 - To promote **local development** and **reduce poverty**

What do we mean by local development?

What is the relationship between local development and poverty alleviation?

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D&D National Program Components

Primary Objective:

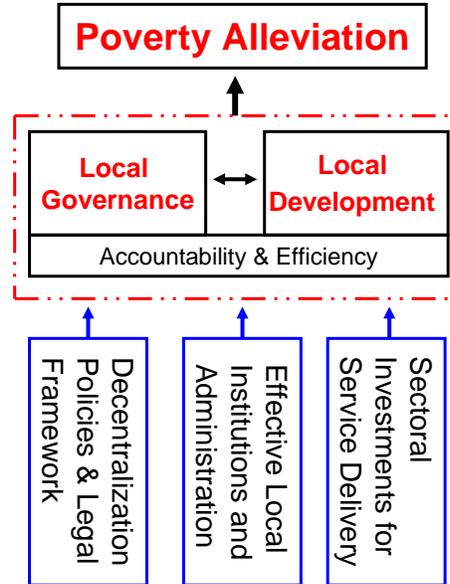
Poverty Alleviation

Intermediate Objectives:

*To improve **Accountability** and **Efficiency***

Through Decentralization & Deconcentration

**D&D National Program:
Expected Outputs**



What do we mean by “Local” Development (1)?

- Local development **outcomes** are typically
 - ✓ an improvement in coverage and quality of local-level infrastructure and services,
 - ✓ a better managed local environment and
 - ✓ growth in local employment and revenue
- But what about the Local development **process** ?
When is development “local”?

“Local” refers to the **“where”**
but most critically, to the **“how”** of the
development process

What do we mean by “Local” Development (2)?

- The locality (as defined by its resources and institutions of economic, social and political nature) is not just the “**recipient**” of development (the space where development takes place) but a primary “**factor**” of it.
- Local Development is development that **makes use of the comparative and competitive advantages** of the locality (of local institutions and resources)

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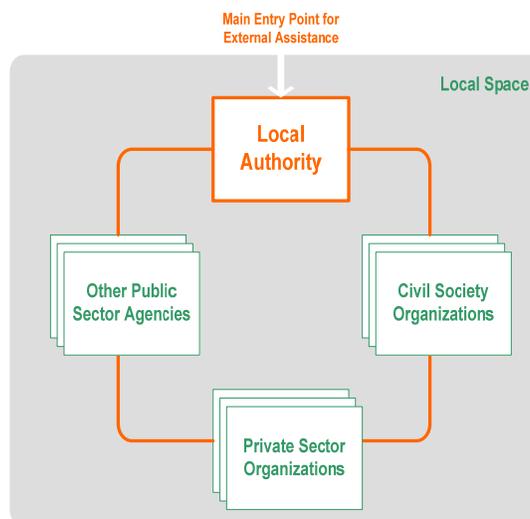
Romeo, 2006

Why “Local Authorities”?

Promoting “Local Development” through Local Authorities aims at making use of their **potential comparative advantages** to:

- Realize **allocative and productive efficiency gains** in public sector expenditures
- Mobilize **additional local resources** for development.

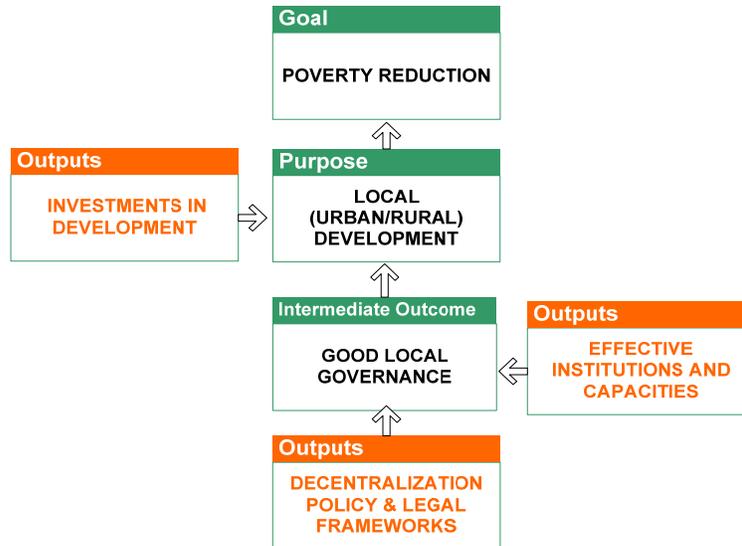
This is the basic rationale for making LA the **entry points** of development aid to local development in a multi-actors “local space”



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Romeo, 2006

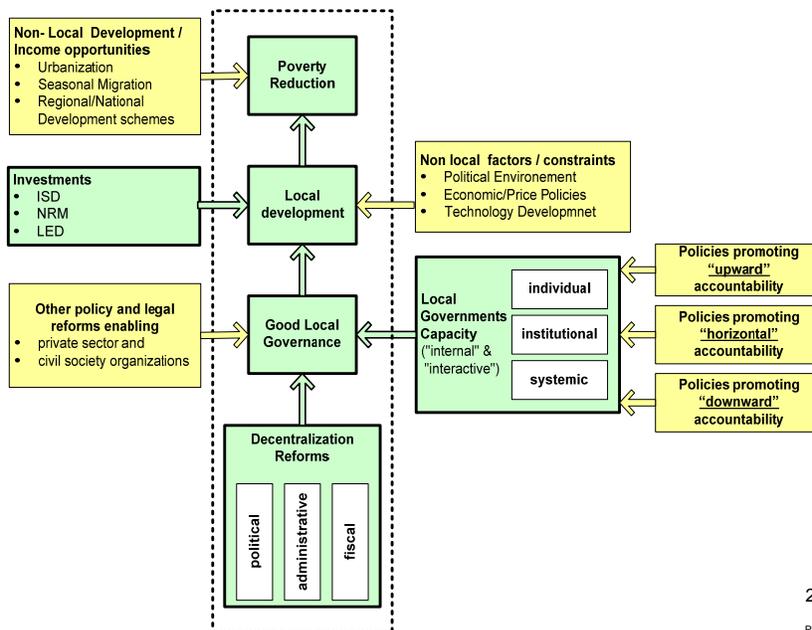
Decentralization reforms and the “Local Development” paradigm



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Romeo, 2006

From decentralization to poverty reduction (a simplified logical framework)



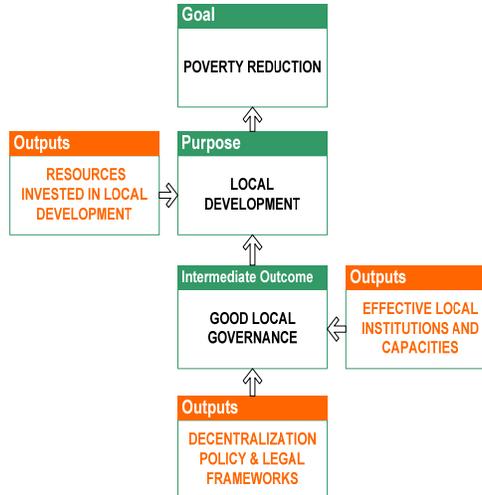
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Romeo, 2006

What does it take for Local Authorities to deliver local development and reduce poverty?

Three sets of conditions are critical to realize the potential of LA to promote local development and reduce poverty

- **Decentralization reforms** that transfers to LA responsibilities and resources for LD
- **Institutional changes** that promote performance, participation and partnerships in local governance
- **Investments** (public and private, domestic and external) in LD



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Romeo, 2006

Major constraints to a “developmental” LA

What are the major constraints for Local Authorities to contribute to local development and poverty reduction?

- **Incomplete decentralization reforms** which stop short of the administrative and fiscal dimensions
- **Limited functional assignments**, urban bias and wide gaps between general local development mandates and actual responsibilities for a limited set of traditional municipal services.
- **Lack of inter-governmental cooperation**, and no/limited role in PRS implementation, limited delegation arrangements
- **Reduced local capacity** and institutional under-development
- **Lack of programmable resources** to fund locally-developed pro-poor policies and programs

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Romeo, 2006

Challenges for Local Development

- Ensure Comprehensive Decentralization (eg, Political, Admin and Fiscal)
- Rationalize and Clarify Functional Assignments
- Ensure Sufficient Resources (eg, Fiscal and Manpower)
- Strengthen Intergovernmental Relations
- Strengthen local capacity (manpower and systems)

**Comprehensive Decentralization
supports Local Development**

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DECENTRALIZATION: ALLOCATING EXPENDITURE RESPONSIBILITIES

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FISCAL DECENTRALIZATION

The Four Pillars:

- **Allocating Expenditure Responsibility**
- Allocating Revenue Sources
- Designing Intergovernmental Transfers
- Structuring Local Borrowing/Debt

-
- ✓ Establish institutional systems and capacity
 - ✓ Mobilize political and administrative will

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ASSIGNING EXPENDITURE RESPONSIBILITIES

Financing should follow function.

BASIC PRINCIPLE:

Correspondence Principle (Subsidiarity)

To increase efficiency, public services should be provided by the jurisdiction having control over the minimum geographic area that would internalize benefits and costs of such provision. (Oates, 1972)

KEY:

- Avoid overlapping / unclear service responsibilities between government levels.

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FINANCE follows FUNCTION

Why?

- To identify need for funds
- To ensure adequacy of funds (hard budget)
- To promote efficiency (type of revenues)

BUT:

- Revenues easier to decentralize
 - Expenditures decentralization: very political
 - Revenue changes less permanent
-
- Revenues can “prime” the pump (Kenya, Cambodia)
 - Revenues can force sectoral decentralization (Thailand)

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FISCAL FEDERALISM PRINCIPLE

THUS, **Centralization is only justified where**

- there are impediments to mobility of people across jurisdictions
- spillovers are significant
- economies of scale are present
- administrative and compliance costs are excessively high at the local level

BUT: Allocation of functions must be linked to capacity.

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THE CLEAR CHOICES: National vs Local Public Goods

National Public Good: National Defense, Macroeconomic stability, Distribution

Local Public Good: Municipal Services (e.g., garbage, fire services, water dist.)

THE DIFFICULTY:

- Most goods don't fit these extreme categories so nicely (especially education and health)
- Most goods must be evaluated on a multi-dimensional basis (i.e., must split provision decision by function)
- Economies of Scale/Spillovers
- Definitions of local governments, states (size and functions) administrative and compliance costs may be too high at local levels
- Assignment might change over time with changes in cost and technological constraints and changes in preferences.

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TYPICAL LOCAL EXPENDITURES

- waste collection
- markets
- bus parks/stations
- environmental management
- planning and land use regulation
- road maintenance
- water distribution
- education (nursery, primary/secondary)
- health (health clinics, regional hospitals)

BASIC ISSUES

Policy vs Administration
Provision vs Production
Government vs Private Sector
Expenditure and Revenue Synchronization

Unbundling Service Delivery: Policy, Production and Provision

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Analytic Framework: Unpacking Service Delivery Functions

- **POLICY**: setting overall service goals, regulations, standards, norms, monitoring and evaluation
- **PROVISION**: managing finance; determining plan/budget priorities; managing budget execution; procurement; overseeing delivery & being answerable for service delivery
- **PRODUCTION**: actually designing, constructing, operating, managing and maintaining service delivery facilities

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Service Provision Responsibility and Actors

Sector / Service:

Actor	Delivery Functions							
	Policy		Provision		Production			
	Regulation Standards	Monitoring	Planning & Budgeting	Financing	Staff Mgm.	Construction	Maintenance	Operation
Central/State Ministry								
Tier 1 LG								
Tier 1 Line Dept.								
Tier 2 LG								
Tier 2 Line Dept.								
Village Committee								
User Committee /CBO								
Frontline Service Unit								
Private Firms/NGOs								

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EXAMPLE: Unbundling Rural Roads

Who are the Actors?

- Ministry of Rural Development (MRD) -Department of Rural Road
- Provincial Department of Rural Development
- District Office of Rural Development
- Commune Councils
- User Groups
- NGOs/Donors and political parties
- Private contractor

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EXAMPLE: Unbundling Rural Roads

What do they Do?

POLICY

- Regulation
- Monitoring and Evaluation

PROVISION:

- Planning and Budgeting
- Financing

PRODUCTION

- Staff management
- Construction
- Maintenance
- Operation

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CURRENT SERVICE RESPONSIBILITIES FOR RURAL ROADS

Source: Local Service Delivery Study, CDRI/UNCDE, 2005

Actor	Delivery Functions						
	Policy		Provision		Production		
	Regulation Standards	Monitoring	Planning & Budgeting	Financing	Construction	Maintenance	Operation
Ministry of Rural Development (MRD) • Department of Rural Road	<ul style="list-style-type: none"> ➤ Implement national policy and laws of the sector ➤ Create new regulations to govern the sector ➤ Establish guidelines and procedure related to technology, standard, 	<ul style="list-style-type: none"> ➤ On-going reporting and visit to the province 	<ul style="list-style-type: none"> ➤ Collect and consolidate project requests from provincial level ➤ Prioritise and select projects ➤ Prepare budget for the department for construction and maintenance activities 	<ul style="list-style-type: none"> ➤ Allocate national budget for the activities ➤ Allocate grant and loan of the ministry for the projects ➤ Mobilise other funding sources 	<ul style="list-style-type: none"> ➤ Provide technical support to the province 	<ul style="list-style-type: none"> ➤ Provide financial and technical support either directly to commune or to the provincial department 	<ul style="list-style-type: none"> ➤ Provide on-going technical and regulatory support to the province
Provincial Department of Rural Development	<ul style="list-style-type: none"> ➤ Ensure enforcement of policy and laws 	<ul style="list-style-type: none"> ➤ Collect information and prepare report to MRD ➤ Monitor commune activities through support staff (TSS and PFT/DFT) 	<ul style="list-style-type: none"> ➤ Collect project requests from districts and communes ➤ Collect project data and prepare provincial plan ➤ Decide on projects and allocate budget for implementation ➤ Support the commune in planning and budgeting of commune projects 	<ul style="list-style-type: none"> ➤ Manage and allocate budget available of the sector in the province ➤ Mobilise external funding sources ➤ Fund activities at the commune level 	<ul style="list-style-type: none"> ➤ Prepare and select contractor ➤ Monitor and check contractor ➤ Provide staffing support to the communes to conduct project design and cost estimation 	<ul style="list-style-type: none"> ➤ Collect and assess road conditions ➤ Prepare request for maintenance activities and budget to the ministry ➤ Conduct some maintenance activities ➤ Set up maintenance committee 	<ul style="list-style-type: none"> ➤ Disseminate information ➤ Train villagers and committee about use of road
District Office of Rural Development		<ul style="list-style-type: none"> ➤ Collect information from the commune level 	<ul style="list-style-type: none"> ➤ Provide support staff to the commune (DFT) 				

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CURRENT SERVICE RESPONSIBILITIES FOR RURAL ROADS

Source: Local Service Delivery Study, CDRI/UNCDF, 2005

Actor	Delivery Functions						
	Policy		Provision		Production		
	Regulation Standards	Monitoring	Planning & Budgeting	Financing	Construction	Maintenance	Operation
Commune Councils	<ul style="list-style-type: none"> Help enforce regulations and laws 	<ul style="list-style-type: none"> On-going checking of road condition 	<ul style="list-style-type: none"> Identify needs Prepare project request and estimate budget needs Commune Councils Commune Councils Decide on priorities to use CSF 	<ul style="list-style-type: none"> Mobilise funding support Finance small projects from CSF 	<ul style="list-style-type: none"> Assist national and provincial level In case of CSF, select and manage contractor during project implementation 	<ul style="list-style-type: none"> Collect road condition information Provide facilitation to village level maintenance activities Collect user fees and conduct maintenance work 	<ul style="list-style-type: none"> Disseminate information Participate in training and meeting
User Groups		<ul style="list-style-type: none"> Help checking and controlling proper use of road 		<ul style="list-style-type: none"> Some forms of user fees collection 		<ul style="list-style-type: none"> Contribute in cash and labor Carry out maintenance activities 	
NGOs/Donors and political parties				<ul style="list-style-type: none"> Provide funding support through grant and loan 	<ul style="list-style-type: none"> Manage construction of road 	<ul style="list-style-type: none"> Allocate funding for maintenance activities 	
Private contractor					<ul style="list-style-type: none"> Provide construction services 	<ul style="list-style-type: none"> Maintain within 6-month period after project completion (and possibly beyond if the CC uses contract for routine maintenance) 	

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SUGGESTED REARRANGEMENT OF SERVICE RESPONSIBILITIES

Source: Local Service Delivery Study, CDRI/UNCDF, 2005

Actor	Delivery Functions						
	Policy		Provision		Production		
	Regulation Standards	Monitoring	Planning & Budgeting	Financing	Construction	Maintenance	Operation
Ministry of Rural Development (MRD) Department of Rural Road	<ul style="list-style-type: none"> Clarify and establish policy and regulation of rural road. Establish guidelines and procedure related to technology, standard, quality, operation and management. 		<ul style="list-style-type: none"> Prepare consolidated national sector budget 	<ul style="list-style-type: none"> Mobilise and set up road funds Make allocation to the responsible road owners. 	<ul style="list-style-type: none"> Prepare technical and quality standard guideline, and implementation options. 	<ul style="list-style-type: none"> Prepare technical and quality standard guideline, and implementation options. 	<ul style="list-style-type: none"> Disseminate quality standard and create public awareness about rural road maintenance work.
Provincial Department of Rural Development		<ul style="list-style-type: none"> Follow up of commune activities. 	<ul style="list-style-type: none"> Assess technical and financial support needs. 	<ul style="list-style-type: none"> Manage sector budget in the province. Allocate road funds to the communes. 	<ul style="list-style-type: none"> Certify list of eligible contractors Assign a technician or engineer to advise the communes. 	<ul style="list-style-type: none"> Provide training to contractors and relevant local communities. 	
District Office of Rural Development							

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CURRENT SERVICE RESPONSIBILITIES FOR RURAL ROADS

Source: Local Service Delivery Study, CDRI/UNCDF, 2005

Actor	Delivery Functions						
	Policy		Provision		Production		
	Regulation Standards	Monitoring	Planning & Budgeting	Financing	Construction	Maintenance	Operation
Commune Councils	➔ Issue and enforce regulations for road usage	➔ On-going checking of road condition in the commune ➔ Prepare public report on road	➔ Collect road condition data ➔ Assess and prioritise needs ➔ Prepare plan and Budget	➔ Allocate road funds to specific project needs	➔ Select and supervise contractor for project implementation	➔ Procure and manage maintenance activities	➔ Disseminate information and public awareness campaigns ➔ Participate in road training
User Groups		➔ Help checking and controlling proper use of road			➔ Monitor construction activities	➔ Monitor maintenance activities	
NGOs/Donors				➔ Provide funding support through grant and loan			
Private contractor					➔ Provide construction services	➔ Provide maintain services	

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CURRENT Vs PROPOSED SERVICE RESPONSIBILITIES FOR COMMUNES

Source: Local Service Delivery Study, CDRI/UNCDF, 2005

Actor	Delivery Functions						
	Policy		Provision		Production		
	Regulation Standards	Monitoring	Planning & Budgeting	Financing	Construction	Maintenance	Operation
Current: Commune Councils	➔ Help enforce regulations and laws	➔ On-going checking of road condition	➔ Identify needs ➔ Prepare project request and estimate budget needs ➔ Decide on priorities to use CSF	➔ Mobilise funding support · Finance small projects from CSF	➔ Assist national and provincial level ➔ In case of CSF, select and manage contractor during project implementation	➔ Collect road condition information ➔ Provide facilitation to village level maintenance activities ➔ Collect user fees and conduct maintenance work	➔ Disseminate information ➔ Participate in training and meeting
Proposed: Commune Councils	➔ Issue and enforce regulations for road usage	➔ On-going checking of road condition in the commune ➔ Prepare public report on road	➔ Collect road condition data ➔ Assess and prioritise needs ➔ Prepare plan and Budget estimate	➔ Allocate road funds to specific project needs	➔ Select and supervise contractor for project implementation	➔ Procure and manage maintenance activities	➔ Disseminate information and public awareness campaigns ➔ Participate in road training

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How to Approach 'Finance Follows Function'?

No "best way" for expenditure allocation

Steps:

- Assign functions based on subsidiarity / correspondence principle, benefit areas of services, externalities, economies of scale and scope, and best international practice
- Establish costs of providing minimum service levels
 - Retrospective approach: assumes current levels are correct
 - Establish minimum spending levels per capita norms (adjusted by climate / geography)
 - Establish minimum physical service standards with costing
- Link costing to affordability

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WHAT ARE THE PRINCIPLES TO CONSIDER?

- Subsidiarity principle (Correspondence Principle)
- Benefit areas of services
- Externalities
- Economies of scale and scope
- Best international practice

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NEED FOR INTER-MINISTERIAL APPROACH:

SECTORAL MINISTRIES MUST BE INVOLVED

Ministry of Interior, Ministry of Economy and Finance, Ministry of Planning, CAR

ROLE for NATIONAL COMMITTEE FOR DECENTRALIZATION AND DECONCENTRATION (NCDD)

What is the role for MEF?

- PFM Program Budget / MTEF Linkage (Mission Statement, Core Functions, Activities)
- Participate in the NCDD

MAIN QUESTION: How best can services be delivered?

(Central, Provincial, District, Commune, Private Sector)

Which Components (Policy, Provision and Production)

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A VIEW FROM THE IMF

(Ahmand, Hewitt, and Ruggiero, 1997, p.27)

- “A country’s social preferences, rather than economic theory, should be the major guide to defining the appropriate level of expenditure decentralization for mixed public goods.”
- “Findings ... would weigh against major changes in expenditure assignments in most countries if these are sought as a means to achieving improved macroeconomic control.”
- “Policymakers ... should perhaps pay more attention to consistency between expenditure assignments and financing arrangement (revenue assignments and the system of intergovernmental transfers), rather than to the extent of centralization or decentralization of expenditure assignments.”
- “Increasing administrative and allocative efficiency, as well as matching public expenditure levels to preferences, is more important than the specific intergovernmental expenditure assignments.”

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EXPENDITURE ALLOCATION STRATEGY

- Understand why you are where you are
- Ensure clear and stable allocation of general responsibilities
- Focus on core services, 'unbundle', then devolve additional specific responsibilities incrementally
- Recognize all local authorities are not equal—consider asymmetric decentralization (Thus, need **Performance Indicators**)
- Phase in additional specific responsibilities to more competent local authorities
- Develop rating system to determine competent local authorities
 - Technical
 - Financial
 - Administrative
 - Planning and Policy
- Monitor implementation and adjust as necessary

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DECENTRALIZATION: ALLOCATING REVENUE RESPONSIBILITIES

By

Prof. Roy Kelly, PhD

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Designing a Fiscal Decentralization Strategy for Cambodia

Ministry of Economy and Finance
Royal Government of Cambodia
(2 – 20 October 2006)

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FISCAL DECENTRALIZATION

The Four Pillars:

- Allocating Expenditure Responsibility
- **Allocating Revenue Sources**
- Designing Intergovernmental Transfers
- Structuring Local Borrowing/Debt

-
- ✓ Establish institutional systems and capacity
 - ✓ Mobilize political and administrative will

2

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OPTIONS FOR REVENUE ALLOCATION

VARIETY OF OPTIONS AND EXPERIENCE

With Choice Depending on:

- Priority of Autonomy
- Level of Duplication
- Compliance and Administration Costs (eg, business)
- Need for Equalization
- Degree of Trust between Governments
- Historical and Institutional Environment

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MODELS FOR REVENUE ALLOCATION

1. REVENUE SHARING (TRANSFER)

All policy, administration and revenue would be under central government control. Revenue could then be share back to the subnational governments through revenue sharing based on formula.

2. TAX SHARING (TRANSFER)

All policy and administration would be under central government control. A portion of the revenue would be given to the subnational governments based either on origin, residence or formula. (eg, transitional economies of the FSU, Vietnam, Cambodia, Laos)

3. SURCHARGES (PIGGY-BACKING)

Administration would be under central control while policy discretion would be given to the subnational governments to set a rate on the nationally-determined tax base. Revenue would then be given back to the regions based on the rate, either to origin or residence

4. CENTRALLY-ASSISTED SUBNATIONAL TAXES (CO-ADMINISTRATION)

Legislative discretion and revenue would be given to subnational governments but the administration could be shared (or co-administered) with the central government (e.g., tax base identification, valuation, assessment, collection and enforcement, appeals).

5. INDEPENDENT SUBNATIONAL TAXES

Legislative discretion, administration and revenue would be under the control of the regional government, under broad guidelines from the central government.

(McLure, 1994)

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BASIC PRINCIPLES FOR TAX ASSIGNMENT

1. Taxes suitable for economic stabilization should be central. Lower-level taxes should be cyclically stable
2. Progressive redistributive taxes should be central
3. Personal taxes with progressive rates should be levied by the jurisdiction most capable of implementing a tax on a global basis
4. Lower-level governments should tax bases with low mobility between jurisdictions
5. Unequally distributed tax bases should be taxed at the central level
6. Benefit taxes and user charges should be used by all levels of government

(Musgrave, 1959)

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TYPICAL LOCAL REVENUES (Tax and NonTax)

- Non-Tax: Some User Charges and Fees/Licenses
 - Property Tax and Land-Based Charges
 - Business Taxes (Permits)
 - Vehicle and transportation taxes
 - Income (Payroll Tax)
 - Sales (Retail)
 - Piggyback Taxes (with Local Rate Discretion)
-
- Tax Sharing and Central-Local Transfers

AVOID TRADE / TRANSIT TAXES

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ASSIGNING REVENUE RESPONSIBILITIES

Basic Principles:

- **Economic Efficiency** (Distortions & Social Welfare Costs)
- **Revenue** (Buoyancy and Stability)
- **Equity** (Benefit and Ability to Pay Principles)
- **Political Acceptability** (Stakeholder Analysis)
- **Administrative Feasibility** (Compliance & Admin. costs)

Local revenues are a **necessary** but **not sufficient** condition for effective fiscal decentralization

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REVENUE POTENTIAL

RESPONSIVENESS

- INCOME
- COSTS OF SERVICES
- INFLATION
- POPULATION

STABILITY

- DIVERSITY IN REVENUE SOURCES
- TAX BASE DEFINITIONS
- TAX RATE STRUCTURE

ISSUE OF REVENUE NEUTRALITY

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ECONOMIC EFFICIENCY

MINIMIZE ECONOMIC DISTORTIONS

- INVESTMENT
- PRODUCTION
- CONSUMPTION
- SPATIAL DISTRIBUTION

MAINTAIN NEUTRALITY

REDUCE SOCIAL WELFARE COSTS

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EQUITY

BENEFIT PRINCIPLE OF TAXATION

- PAYMENT RELATED TO BENEFITS

ABILITY TO PAY PRINCIPLE OF TAXATION

- PAYMENT RELATED TO ABILITY TO PAY

OPTIONS

- PROPORTIONAL
- PROGRESSIVE
- REGRESSIVE

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ADMINISTRATIVE FEASIBILITY

MINIMIZE ADMINISTRATIVE COSTS

MINIMIZE COMPLIANCE COSTS

TAX ADMINISTRATION IS TAX POLICY

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POLITICAL ACCEPTABILITY

PRIME MINISTER / GOVERNOR

LEGISLATURE (PARLIAMENT / COUNCIL)

JUDICIARY

TAXPAYERS

- BUSINESS
- INDIVIDUALS
- NON-PROFIT ORGANIZATIONS

OTHER STAKEHOLDERS

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ADMINISTRATION: THE CRITICAL OBSTACLE

- Problems:**
- Lack of citizen credibility
 - Lack of political will
 - Low collections
 - Weak Enforcement
 - Incomplete Revenue Base Information

Possible Solutions:

- Central Administration (e.g., property taxation in Chile)
- Co-Administration (e.g., property taxation in Indonesia)
- Local Administration (e.g., Single Business Permit in Kenya)
- Privatized Administration (e.g., mkt management in Uganda)

The key is **Revenues and Rate Discretion**

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REVENUE OPTIONS FOR LOCAL SERVICE DELIVERY

REVENUE TRANSFERS → Received by Local Governments

- Central-Local Transfers (block, categorical, equalization)
- Shared Taxes (eg, income taxes, VAT, property taxes, fuel taxes)

LOCAL OWN REVENUES → Levied by Local Governments

- **Local Fees and Charges and Own Taxes**
 - User Charges and Fees/Licenses
 - Business Taxes (license / permits)
 - Property Tax and Land-Based Charges
 - Vehicle and transportation-related taxes
 - Income (payroll tax)
 - Sales (selective excise taxes)
- **Local Surcharges / Piggyback Taxes (with Local Rate Discretion)**

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WHY LOCAL OWN REVENUES?

- Realizes decentralization efficiency gains
- Promotes accountability and ownership
- Ensures local autonomy
- Facilitates cash flow management
- Reduces incentives for extra-budgetary funds

Local own revenues require discretion (**at the margin**)
in **tax rates** and **administration**.

Local own revenues are a **necessary** but **not sufficient** condition for **effective fiscal decentralization** and **improved service delivery**

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Design Principles for Revenue Systems

- **Revenue** (Buoyancy and Stability)
- **Administrative Feasibility** (Compliance & Admin. costs)
- **Economic Efficiency** (Distortions & Social Welfare Costs)
- **Equity** (Benefit and Ability to Pay Principles)

Subnational Considerations:

- Does tax promote political responsibility/accountability (own source revenues)?
- Does tax base mobility cause distortions in location of labor and capital?
- Can tax base be identified by location (source, residence)?
- Can tax policy, structure and administration functions be vertically “unbundled”?

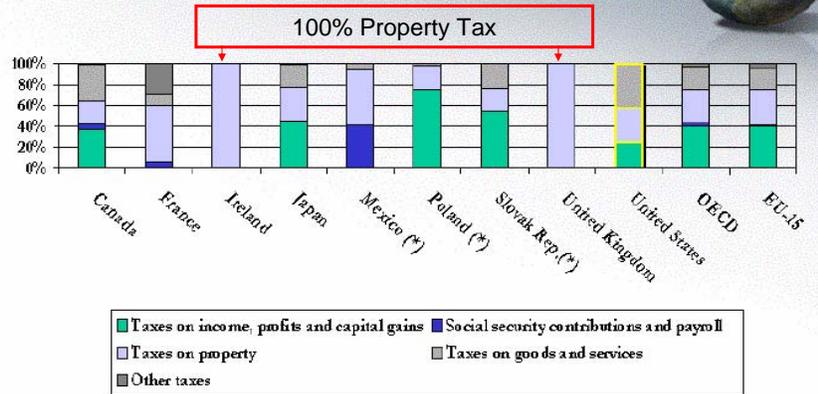
Benefit Principle: User Charges (service fees, public prices, benefit charges)

Ability to Pay Principle: Property Taxes, Vehicle Taxes, Payroll Taxes

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Chart 4: Structure of state and local government tax receipts, 2003



*) 2002 figures

Owens, 2005

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USER CHARGES

- Fair and Equitable (benefit principle)
- Economically efficient

Examples:

- service fees (licenses, administrative fees for services)
- public prices (public utilities, admission charges)
- Benefit taxes/charges (special assessments, development extractions)

BUT: User charges tend to be underutilized, inefficient, & costly to administer

Design Principles:

- Keep it simple
- Avoid 'nuisance charges'—focus on water, garbage collection, bus parks, and markets
- Ensure public acceptance—broad coverage, low rates & consider distributional impact
- Consider outsourcing collection / management contracts

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PROPERTY TAXATION

- Fair and Equitable (Ability To Pay & Captures Benefits)
- Economically Efficient (Land)
- Revenue Potential Is Good / Stable
- Administration Is Relatively Simple

Examples: Land, Building, Improvements

BUT: Politically sensitive (visible, lumpy, property owners) yet good for increasing government accountability.

Design Principles:

- Keep it simple
- Focus on administration, secondary priority on policy fine tuning
- Adopt 'collection-led' strategy: collection, coverage, and valuation
- Create proper incentives for taxpayers, tax dept, and local government.

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ROLE OF PROPERTY TAXATION

Developed Countries

- **1-3 percent of GDP**
 - 2.5-3.0% Canada, US, UK
 - 1.5-2.5% NZ, Japan
 - 1.0-1.5% Aus, France, Den, Sweden

- **40-80 percent of Local Govt. Revenues**

Over 70% Canada, UK, US, Ireland, Aus, NZ

- **2-4 percent of Total Govt. Revenues**

Developing/Transitional

- **0.5 percent of GDP**
 - Argentina (0.9%), Chile (0.6%),
 - Indonesia (0.45%) Mexico (0.31),
 - Nicaragua (0.13%)

- **20-60 percent of Local Govt. Revenues**

- **1-2 percent of Total Govt. Revenues**

Source: Bahl, 2002, Bird and Slack, 2004

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OTHER ASSET TAXES: Registered Personal Property

Fair and Equitable (benefit principle, ability to pay)
Economically efficient (if linked to road costs)

Examples: Motor vehicles, aircraft, boats, bicycles, etc

Vehicle asset tax is for financing road system assets in region, whereas fuel levy is a way of financing road maintenance: Two part levy – access or “club membership” fee plus usage fee

Design Principles:

- Keep it simple
- Provincial level with minimal variance in tax rates or uniform tax rate and base (through tax sharing)
- Central or local administration, depending on economies of scale

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BUSINESS TAXES (Presumptive Income / Sales)

Fair and Equitable (benefit principle, “ability to pay”)
Economically efficient (if lump sum)

Examples: Business Permits/Licenses, Business Privilege Tax, Patente

- Good where there are poor business records for income or sales taxes
- Good to tax businesses below income or VAT tax thresholds

Design Principles:

- Keep it simple
- Structure as lump sum with some differentiation by size of business
- Use local administration due to proximity, staff skills, and links to land use planning and business regulation
- Local rate discretion within range

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Single Business Permit in Kenya

BEFORE: Complex, established system of business licensing

- Multiple licenses and licensing agencies
- Illogical & inconsistent tariff structures for LA(s) and business activities
- Poor administration (incomplete registers, misclassifications, no billing, poor collection, ineffective enforcement, lack of taxpayer service)
- Ineffective regulatory requirements
- Low level of local revenues, with little scope for increase

AFTER: Single Business Permit Reform (1999):

- One Permit per business (local); central licensing abolished.
- Consistent tariff structure by size and type, with discretion given to local govts.
- Simplified administration system
- Initial revenues went up 30-40 percent (1999-2001)
- SBP now accounts for 15 percent of own revenues; largest source in counties (27%) and small towns (22%).
- Widely appreciated by the business sector and LA(s)—higher revenues, lower compliance costs. (Abuodha and Bowles, 2000)

Kelly and Devas (2001)

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Single Business Permit Fee Schedule (Kenya, 1999)										
BRIMS CODE	CATEGORIES OF BUSINESS	Sched N ^o	6	7	8	9	10	11	12	13
100	GENERAL TRADE, WHOLESALE, RETAIL, STORES, SHOPS, PERSONAL SERVICES Such as : Distributors, Traders, Wholesalers, Hypermarkets, Department Stores, Supermarkets, Show Rooms, Boutique	Base Value	250	300	350	400	500	600	700	850
		103	Mega Store, Hypermarket Large Multi-Department Store, Hypermarket Over 100 employees or Premises over 3,000 m	60	15,000	18,000	21,000	24,000	30,000	36,000
105	Large Trader, Shop, Retail Store or Personal Service From 21 to 100 Employees &/or Premises from 300 to 3000 m2. Fair Location	20	5,000	6,000	7,000	8,000	10,000	12,000	14,000	17,000
110	Medium Trader, Shop or Retail Service From 5 to 20 employees &/or premises from 50 to 300 m2. Fair Location	10	2,500	3,000	3,500	4,000	5,000	6,000	7,000	8,500
115	Small Trader, Shop or Retail Service Up to 4 employees &/or Premises less than 50 m2. Far away Location.	5	1,250	1,500	1,750	2,000	2,500	3,000	3,500	4,250
120	Kiosk Light or Temporary construction less than 5 m2	4	1,000	1,200	1,400	1,600	2,000	2,400	2,800	3,400
195	Other Wholesale-Retail Traders, Stores, Shops and Services	4	1,000	1,200	1,400	1,600	2,000	2,400	2,800	3,400

INCOME TAXES: PAYROLL OR WAGE TAX

Fair and Equitable (ability to pay but limited to formal sector)
Relatively economically efficient (linked to labor mobility)

Major Characteristics and Considerations

- Relatively simple compared to personal income tax
- Employment income can be assigned to locations
- Tax export/import issues; mobility/migration issues

Design Principles:

- Keep it simple
- Flat rate, not progressive rates, if local administration
- ‘Piggyback’ on national tax administration, if possible

Avoid Local Personal Income Taxes

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SELECTIVE EXCISE DUTY

Fair and Equitable (ability to pay)

Local examples: hotel rooms, entertainment, airport taxis/ car rentals

Major characteristics and issues

- Single stage tax typically at **manufacturer and import level** at high rates on selected commodities; economies of scale in administration; separation of consumption and tax points make regional assignment of tax difficult
- Local production/consumption can be taxed, but makes “exports” uncompetitive (issues of tax exporting, mobility distortions)

Design Principles:

- Keep it simple
- Low unit rates on as broad base as possible
- Avoid investment, consumption and production distortions

Avoid Local Retail Sales Taxes

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CHALLENGES

- Financing sustainable local service delivery requires **creative combination** of central transfers, local own source revenues, and community contributions.
- Local **'own source' revenues are necessary** for improved governance, efficiency and accountability.
- **KEEP** revenue policy and administrative structure **SIMPLE**
- Apply **direct user charges where possible**, but remember the poor.

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CHALLENGES

- **Strengthen other 'local revenues'** such as property taxation, betterment taxes, business taxes, excises,, payroll taxes... **Avoid mobile tax bases**.
- Consider **'Piggy-Back' tax** on national level personal income tax/payroll taxes as own source revenues.
- Creatively use **"co-administration"**-- involve both central and local government. **Share information**.

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Property Taxation: Options for Cambodia

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Designing a Fiscal Decentralization Strategy for Cambodia

Ministry of Economy and Finance
Royal Government of Cambodia
(2 – 20 October 2006)

WHY PROPERTY TAXATION?

1. Revenue Potential Is Good / Stable
2. Administration Is Relatively Simple
3. Economically Efficient For Land
4. Taxes On Ability To Pay
5. Captures Benefits Of Capital Investments

BUT: Politically sensitive (visible, lumpy, property owners)

Thus: How to simplify, improve accountability, reduce lumpiness/visibility, ...

ROLE OF PROPERTY TAXATION

Developed Countries

- **1-3 percent of GDP**
 - 2.5-3.0% Canada, US, UK
 - 1.5-2.5% NZ, Japan
 - 1.0-1.5% Aus, France, Den, Sweden

2-4 percent of Total Govt. Revenues

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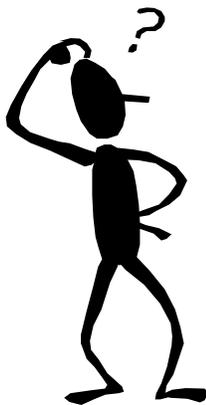
- **20-60 percent of Local Govt. Revenues**

Source: Bahl, 2002, Bird and Slack, 2004

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BASIC POLICY VARIABLES



- What is taxed?
- How is it taxed?
- How to structure the tax rates?
- How to structure the tax admin?

- **What implementation strategy?**

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WHAT IS TAXED?

- **What is to be included?**

- Land
- Buildings
- Machinery & Equipment

- **What is to be excluded?**

- Foreign Embassies
- Government
- Religious
- Education & Health



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Recommendation 1: Tax Base Definition

Define a broad base to:

- Mobilize political support
- Maximize fairness
- Minimize economic distortions
- Facilitate administration
- Encourage greater taxpayer equity & compliance

Minimize exemptions

- Exemptions = subsidies (**equity**)
- Exemptions reduce tax base (**efficiency**)
- Exemptions reduce **revenues**

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TAX RELIEF OPTIONS?

- **Tax Deferrals** (equals government loan)
- **Circuit Breakers** (reduction based on income)
- **Credit or Rebates** (tax amount reduction)
- **Differential Rates** (tax rate reduction)
- **Valuation Deduction**** (tax base reduction)
- **Exemptions** (tax base reduction)

** Valuation Deduction: Assessment Ratios, Building valuation deduction)

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HOW IS IT TAXED?

PURPOSE:

To determine the relative allocation of the tax burden

Property Characteristics

- Per Property
- Area based

Ad Valorem (market-based tax):

- Individual Valuation: Kenya, Uganda, Malawi, South Africa
- Simple Mass Valuation: UK, Indonesia, and Latin America
- Computer Assisted Mass Appraisal (CAMA): North America, Europe

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Recommendation 2: Assessment Basis (Area or Valuation)

Choose basis that will maximize equity at affordable administration and compliance costs

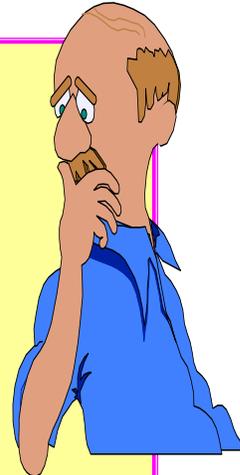
Ad valorem property tax correlated with market transactions can provide taxpayer equity and revenue buoyancy

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WHAT TAX RATE STRUCTURE?

- **Uniform System**
- **Classified System**
- **Progressive Rates**
 - St. Lucia, Jamaica, Chile, Indonesia
 - Korea
- **Links to Decentralization:**
 - Provide local rate discretion
 - Range of tax rates, with min and max



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Recommendation 3: Tax Rate Structure

Remember tax rate, tax assessment ratios, and valuation deductions determine effective statutory tax rates

Fewer effective statutory tax rates minimize economic distortions, simplify administration and reduce compliance costs

Grant tax rate discretion to local governments, within a range

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HOW TO ADMINISTER?

ADMINISTRATION COMPONENTS:

- Property Information
- Valuation Dimensions
- Assessment and Billing
- Revenue Collection
- Enforcement
- Taxpayer Services

CENTRAL, LOCAL OR CO-ADMINISTRATION?

- Economies of scale
- Need for information access (links to other taxes/policy)
- Administration capacity
- Institutional and personal incentives

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TAX ADMINISTRATION IS TAX POLICY

Within the Policy Context:

- Is property information properly captured on the tax roll? Is it complete? Is it up-to-date? Is it accurate?
- Are estimated property valuations accurate and timely? Are appeals handled objectively and fairly, in a timely manner?
- Are assessments following legal norms? Are exemptions being properly applied? Are bills produced and delivered?
- Are payments collected and properly accounted for?
- Are premiums, sanctions and penalties administered in an open, transparent and accountable manner?
- Are taxpayers treated as customers, promoting greater voluntary compliance?

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The Critical Obstacle

Although policy can be fine tuned, the primary obstacle to successful property tax mobilization is:

Weak Administration

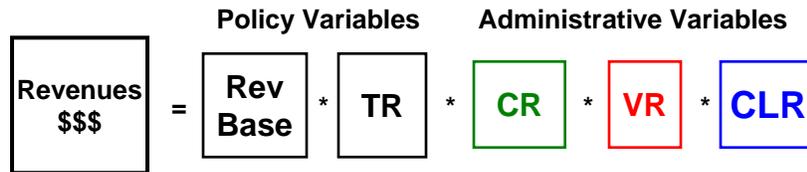
Problems:

- Lack of political will
- Lack of citizen credibility
- Revenue base information: lacking, incomplete, or dated
- Low collections
- Weak enforcement: virtually non-existent

**Need comprehensive approach:
Don't Focus Exclusively on Valuation**

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Analytical Model for Revenue Mobilization



Rev Base: Unknown Revenue Base

TR: Tax Rate / Fee Structure

CR: Coverage Ratio

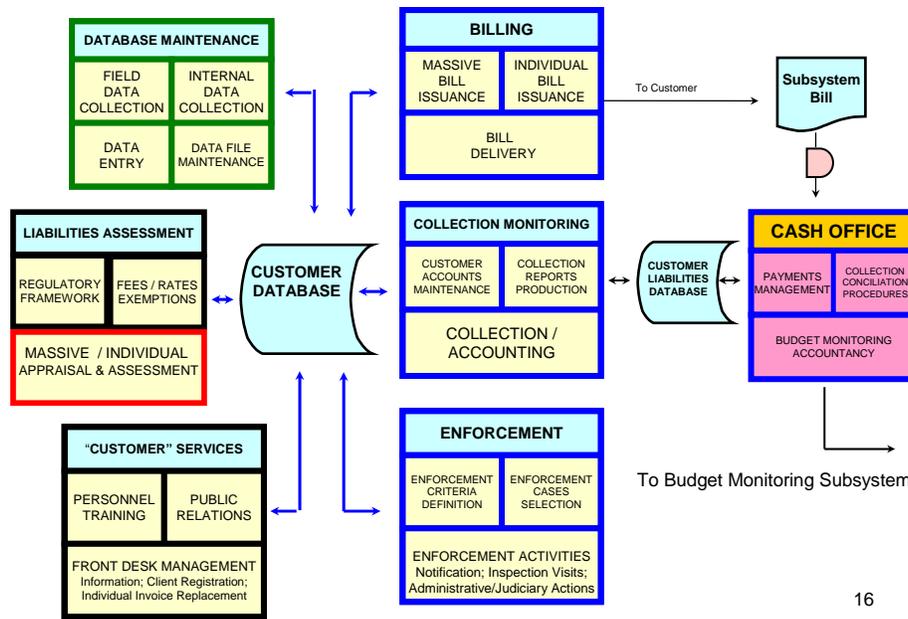
VR: Valuation / Classification Ratio

CLR: Collection / Enforcement Ratio

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PROPERTY TAX OPERATIONS MANAGEMENT SYSTEM



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Administrative Issues for Cambodia

Current Situation:

- Unused Land Tax
- Land Transfer Tax (fees)

Observations:

- Base is limited (small number of taxpayers/parcels)
- Dependent on secondary data for administration (land)
- Data management is manual
- Committees for Valuation with national Prakas ('Land Value Book')
- Three Land Value Zones in PP, with numerous adjustments
- Billing system, manual, by tax department/committee
- Enforcement Options available, but largely linked to transaction timing
- Interest and penalties lower than for other taxes
- Limited tax payer education program
- Tax administration staff for unused land tax (4 in PP)

Way Forward for Cambodia

Need simulation model on possible impacts

- Hypothetical properties
- Impact of Tax Burden on individual households
- Identify Winners and Losers
- Estimate possible tax revenues
- Estimate administrative and compliance costs

Need to Identify administrative procedures:

- Data Capture
- Data Management
- Valuation
- Tax Assessment and Billing
- Collection and Enforcement
- Appeals and Taxpayer Service**

Need Tax Department Resources and Capacity Development (systems and personnel)

- Rationalize property information exchange with third parties
- Simplify Valuation System
- Explore co-administration options with PP (C/S level)
- Develop/Pilot PT operations management system

Need Taxpayer Education Program

- Expansion of Taxable Properties / Taxpayers
- Expansion to include land and housing
- Shifting to Annual / not transaction linked tax

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Conclusions

MOBILIZE POLITICAL, OPERATIONAL AND TAXPAYER SUPPORT

- Support is necessary for enactment and for reform sustainability
- Capitalize on reform environment
- Launch internal/external stakeholder campaign
- Establish personnel and systems capacity

FOCUS ON TAX ADMINISTRATION

- Establish simple policy and operational procedures
- Introduce appropriate computerization
- Introduce co-administration (eg, central with delegated functions)

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CREATE PROPER INCENTIVES

- Link collections to improved services
- Keep revenue policy and administration simple and transparent

THINK COMPREHENSIVELY BUT IMPLEMENT INCREMENTALLY

- Identify improvements to increase the coverage (**CR**), valuation (**VR**), and collection (**CLR**) ratios
- Recognize system limitations to quantity of change

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REFORM IS A CONTINUAL AND INTERACTIVE PROCESS

- Prepare to win the war **NOT** each battle
- Get fundamentals right and incrementally introduce improvements

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CENTRAL – LOCAL ADMINISTRATION TRANSFERS

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Designing a Fiscal Decentralization Strategy for Cambodia
Ministry of Economy and Finance
Royal Government of Cambodia
(2 – 20 October 2006)

PRESENTATION SUMMARY

- Why Central-Local Grants?
- Designing Central-Local Grants
- Central-Local Grants: Typology
- Central Local Grants in Cambodia

IMPORTANCE OF CENTRAL-LOCAL GRANTS

- Dominant source of revenue for subnational governments in some countries:

South Africa	85%
Indonesia	72%
Provinces	72%
Local	85%
Nigeria	67% to 95%
Mexico	70% to 90% (poorer states)
Pakistan	82% to 99%
- Design of grants affects efficiency, equity and fiscal discipline.

Source: Shah, 2002

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CENTRAL-LOCAL FISCAL DILEMMA

BASIC ALLOCATION DECISIONS:

EXPENDITURES: Primarily Local
REVENUES: Primarily Central

CREATES: **FISCAL IMBALANCES:**

VERTICAL IMBALANCE (Between Central and Local)
HORIZONTAL IMBALANCE (Among Local)

KEY IS:

How to combine **advantages from decentralizing major expenditures** with the **advantages of centralizing major revenue sources**?

Dominant Role of Central-Local Fiscal Grants

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WHY CENTRAL-LOCAL GRANTS?

- Political Influence / Control (politics)
- Close the fiscal gap (vertical imbalance)
- Equalize fiscal capacity/needs (horizontal imbalance)
- Adjust for spillovers (externalities)
- Increase central expenditure effectiveness (merit goods)

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DESIGN CRITERIA FOR CENTRAL-LOCAL GRANTS

- Safeguard grantor's objectives
- Promote Local Budget Autonomy
- Revenue adequacy
- Simplicity and Transparency
- Predictability and Stability
- Equity and Fairness
- Efficiency (minimize distortions)
- Incentives

Source: Shah, 1994

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TYPES OF GRANTS

- **Block** (General Purpose, Lump Sum, Unconditional)
- **Categorical** (Specific, Tied, Conditional)
 - Matching vs Nonmatching Structure
 - Matching (open and close ended)
- **Cost Reimbursement**

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CENTRAL-LOCAL GRANT STRUCTURE

Key Components:

- **Size of the Pool**
(ad hoc, percentage, reimbursement basis)
- **Allocation Criteria**
(derivation, formula, cost reimbursement)
- **Distribution Approach**
(general/selective, matching & non-matching)

**Ensure Predictability, Transparency
and Accountability**

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CENTRAL-LOCAL GRANT STRUCTURE

Distribution/Channeling Approach

Non-matching transfers:

- General (unconditional) (**higher welfare**)
- Selective (conditional)

Selective matching transfers

- Closed-ended
- Open-ended (**higher expenditure stimulation**)

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CENTRAL-LOCAL GRANT STRUCTURE

Method of allocating total among eligible units	Method of determining total to be distributed		
	Specified share of central tax (or % of GDP/Taxes)	<i>Ad hoc</i> decision	Reimbursement of approved expenditures
Origin of collection of the tax	A	----	---
Formula	B	F	---
Total/partial cost reimbursement	C	G	K
<i>Ad hoc</i>	D	H	---

(Bahl and Linn, 1992) 10

Explanation of Grant Types (1)

- **Type A:** Revenue shares are shared on a predetermined basis and allocated based on derivation.
- **Type B:** Revenues are shared on a predetermined basis and allocated based on a formula
- **Type C:** Revenues are shared on a predetermined basis and allocated either fully or partially on a cost reimbursement basis for government programs.
- **Type D:** Revenues are shared on a predetermined basis and allocated based on ad hoc basis

(Bahl and Linn, 1992)

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Explanation of Grant Types (2)

- **Type F:** Revenues shares are determined on an ad hoc manner but distributed on a formula basis
- **Type G:** Revenues shares are determined on an ad hoc manner allocated by central government either fully or partially on a cost reimbursement basis for government programs.
- **Type H:** Revenues are decided and distributed on an ad hoc basis
- **Type K:** Revenues are determined and allocated by central government either fully or partially on a cost reimbursement basis for government programs.

(Bahl and Linn, 1992)

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Appropriateness of Various Grant Types

Objective	Grant Type										
	A	B	C	D	F	G	H	K			
Of national government											
• Maintain control over local finances	-	-	-	?	+	+	+	+			
• Stimulate expenditures for a particular function/overall tax effort	?	?	+	?	?	+	?	+			
• Equalize services and fiscal capabilities among localities	-	+	?	+	+	?	+	?			
• Increase local tax effort	?	?	+	+	?	+	?	+			
Of local government											
• Maintain control over local finances	+	+	?	?	-	-	-	-			
• Plan efficient budget	+	+	?	?	-	-	-	-			
• Increase adequacy of local revenues	+	+	+	?	-	-	-	+			
Joint											
• Minimize administrative costs	+	?	-	?	?	-	?	-			

World Bank (2000) 13

CONFLICTING GOALS?

Central Government Goals

- Exert Control over Local Finances
- Increase Local Tax Effort
- Stimulate Expenditures for a Particular Function or Overall Tax Effort
- Minimize Administrative Costs
- Equalize Services and Fiscal Capabilities among Localities

Local Government Goals

- Maintain Control over Local Finances
- Increase Local Revenue Flow
- Plan Efficient Budget based on local priorities
- Minimize Administrative Costs

Bahl, 2000

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THE POLITICAL ECONOMY OF GRANTS

- Prime Minister
- Parliament
- Ministry of Economy and Finance
- Ministry of Interior
- Line Ministries
- Urban Local Government
- Rural Local Government

Adapted from Bahl, 2000

DIVERSE INTERESTS: MUST MOBILIZE SUPPORT

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GRANT DESIGN: THINGS TO DO

- Be clear on objectives
- Establish a mixture of grants
- Maintain simplicity and transparency
- Make formulae 'demand driven' not based on existing supply
- Preserve local autonomy (block vs categorical)
- Ensure continuity / predictability
- Creatively use 'release' conditions
- Establish a monitoring system

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GRANT DESIGN: THINGS TO AVOID

- Avoid 'tax by tax' sharing
- Avoid political, ad hoc grants
- Avoid excessive conditions on use (ie, allow a level of discretion within and between conditional grants)
- Avoid perverse incentives (eg, no deficit grants)
- Avoid shocks: need transition approach

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CLARIFY OBJECTIVE TO DESIGN SOLUTION

- Political Influence / Control
(politics—ad hoc block / categorical, matching/non-matching)
- Close the fiscal gap
(vertical imbalance—reassign responsibilities, tax sharing or general grants)
- Equalize fiscal capacity/needs
(horizontal imbalance—formula general grants)
- Adjust for spillovers
(externalities—expand boundaries to internalize, specific matching grants)
- Increase central expenditure effectiveness
(merit goods—specific matching grants)

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CENTRAL-LOCAL GRANTS IN CAMBODIA (1)

- **Need mixture** of central-local grants to achieve various objectives
- **Keep grant system simple** to promote transparency, predictability and accountability.
- **Need 'Block Grant'** for basic local functions (eg, Commune/Sangkat Fund). NEED District Fund and Province Fund
- **Need 'Categorical grants'** for specific functions (eg, roads, education, health)

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CENTRAL-LOCAL GRANTS IN CAMBODIA (2)

- **Block grants should be formula-based.** Primary basis should be population. What other factors should be included? Equal weights? Poverty Index?
- **Categorical grants should be formula-based.** Factors will depend on the specific purpose. (Eg, primary education should be based on number of school age children)
- **Need Institutional Basis** to Manage/Oversee Central-Local Grant System

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Subnational Governance Administration: Draft Financial Provisions

DRAFT: For Classroom Discussion Only

Designing a Fiscal Decentralization Strategy for Cambodia

Ministry of Economy and Finance
Royal Government of Cambodia
(2 – 20 October 2006)

1

SUBNATIONAL FINANCE PROVISIONS

- Article 1: Fundamental Principles
- Article 2: Locally-Derived Revenues
- Article 3: Revenues from National Sources
- Article 4: Subnational Borrowing
- Article 5: Subnational Financial Management
- Article 6-7: Intergovernmental Fiscal Committee (IFC)

Schedule A: Allocation of Revenue Powers

2

Article 1 (Principle 1-2)

(1) Subnational finance is structured:

- **To promote** efficiency, accountability and transparency, revenue adequacy and mobilization, local socioeconomic development
- **To mitigate** fiscal disparity
- **To assure** delivery of essential services

(2) Subnational governments to be financed with:

- **Locally-derived taxes and non-tax revenues**
- **Centrally-derived revenues**
 - Tax Sharing
 - Revenue Sharing
 - unconditional grants (general purpose)
 - conditional grants (specific purpose)
- **Borrowing**

3

Article 1 (Principles 3-5)

(3) Subnational government empowered to independently obtain revenues for assigned functions

(4) Central government will provide funds to assist with assigned functions and sufficient funds to meet delegated functions

(5) Subnational government shall have balanced budget in accordance with relevant budget law, sub-decree and financial regulations

4

Art. 2 (1-4): Locally-derived revenues

- Local revenues should not prejudice national economic policies, inter-jurisdictional trade or national mobility of goods, services, capital or labor.
- Local tax revenues shall be defined in national legislation, with minimum and maximum rates. Subnational level shall have right (**responsibility**) to choose tax rate, collect and administer within limits set by national legislation.
- Schedule A provides for locally derived revenues for provinces, Phnom Penh, urban and rural districts and communes.

5

Art. 2 (5-6): Locally-derived revenues: Non-Tax Revenues

- Subnational government administrations can derive non-tax revenues:
 - local fees and charges for:
 - local public services offered by them;
 - the issuance of licenses, permits, authorizations and issuance of other documentation, at the discretion of subnational government administration;
 - rents and sale of property
 - revenues and interest from their own shareholdings and income generating activities;
 - donations, interest, fines and penalties;
 - agency fees linked to delegated responsibilities;
 - revenues from self contribution and
 - other revenues as defined in sub decree.
- Subnational government administration can set local fees and charges rates, collection and administration procedures in accordance with policies and general principles in sub-decree. ⁶

Schedule A: Revenues (1)

- **Central Revenues:**
 - Tax on Salary
 - Tax on Profit
 - Tax on Turnover
 - Tax on Value Added (VAT)
 - Customs and Excises
 - Natural Resources
 - Others (see list)

- **Provincial Locally Derived Revenues:**
 - Motor vehicle fees and related transfer taxes
 - Rents on provincial properties
 - User charges on provincial services
 - Agency fees for delegated services
 - Any non-tax revenue authorized by sub-decree
 - Other taxes authorized by national legislation

7

Schedule A: Revenues (2)

- **Phnom Penh :**
 - Motor vehicle fees and related transfer taxes
 - Property Related Taxes and Fees:
 - Real property
 - Unused land tax
 - Land use fees
 - Land transfer taxes
 - Rents on municipal properties
 - Business Licenses (Patente)
 - User charges on municipal services
 - Agency fees for delegated services
 - Regulatory Fees (Parking, Advertising, Animal Slaughter)
 - Self Contribution
 - Any non-tax revenue authorized by sub-decree
 - Other taxes authorized by national legislation

8

Schedule A: Revenues (3)

- **Rural and Urban Districts:**

- Property Related Taxes and Fees^{**}:
 - Real property
 - Unused land tax
 - Land use fees
 - Land transfer taxes
 - Rents on district properties
- Business Licenses (Patente)^{**}
- User charges on district services
- Agency fees for delegated services
- Regulatory Fees (Parking, Advertising, Animal Slaughter)
- Self Contribution
- Any non-tax revenue authorized by sub-decree
- Other taxes authorized by national legislation

^{**} In rural districts, revenues to be shared with communes

9

Schedule A: Revenues (4)

- **Commune:**

- Property Related Taxes and Fees^{**}:
 - Real property
 - Unused land tax
 - Land use fees
 - Land transfer taxes
 - Rents on commune properties
- Business Licenses (Patente)
- User charges on commune services
- Agency fees for delegated services
- Regulatory Fees (Parking, Advertising, Animal Slaughter)
- Self Contribution
- Any non-tax revenue authorized by sub-decree
- Other taxes authorized by national legislation

^{**} Revenues to be shared from Rural Districts

10

Art. 3 (1): Centrally-derived revenues

- Shared Taxes, in accordance with national legislation (eg, gasoline tax for road maintenance)
- Unconditional Transfers for assigned or delegated functions and for equalizing resources among local governments as defined in sub-decree.
- Conditional Transfers for assigned or delegated functions to achieve national objectives as defined in sub-decree.

11

Art. 3 (2-5): Transfers

- Distributed **directly** to individual level of subnational government **in accordance with treasury regulations, at least 3 times a year.**
- Unconditional Transfers:
 - Allocated on objective formula, based on at least 60% for population and any other objective criteria.
 - Formulas to be determined upon recommendation by IFC to promote equalization, poverty alleviation, revenue mobilization, and expenditure management improvements.
- Conditional Transfers:
 - Allocated on objective transparent formula, based on service need factors as defined in national legislation for each transfer

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Art. 4: Borrowing

- Subnational government may borrow for development or recurrent expenditure based on national legislation
- National legislation to be enacted only after recommendation from Intergovernmental Fiscal Committee (see Art. 7-8)
- Subnational government can only borrow with approval from local council

13

Art. 5: Financial Management

- All revenues, expenses, assets, liabilities, and investments to be prudently managed in the interests of the concerned local governance authority as reflected in the annual budget of the respective local governance authority.
- Investments, identified in medium term development plan to be made in the annual investment program and the annual budget of the respective local governance authority.

Separate sub-decree(s) to cover:

- Budgetary and financial planning
- Management of local derived revenues
- Management of centrally derived revenues
- Management of local expenditures, assets, and liabilities
- Financial accounting and reporting
- Internal and external controls
- Fiscal/Financial discipline measures
- Subnational borrowing
- And other relevant financial matter

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Art. 6 (1-4): Intergovernmental Fiscal Committee Cambodia (IFCC)

- Committee Members (11 members):
 - Minister for Economy and Finance (Chairman)
 - Supreme National Economic Council Chairman
 - Representative of MEF *
 - Representative of MOI*
 - Subnational Government Representatives**
 - Provincial
 - Rural District
 - Urban District (municipal)
 - Commune
 - Two Private Sector Members***
 - Secretary General, MEF (Secretary)

Co-opted Members: (eg, line ministries, private sector, others)

* Secretary of State Level

** Nominated by respective associations. MOI to nominate prior to associations.

*** Nominated by MEF, in consultation with MOI

15

Art. 6 (5-6): IFCC Functions

Principal function: To determine basis for sharing revenue from national resources and to ensure that the sharing is equitable as between:

- the national and subnational governance administrations; and
- the provincial, municipal, district and commune governance administrations.

The Committee shall –

- (a) inform parliament, Government and the subnational governance administrations of its recommendations concerning apportionment of national revenues to the central government and subnational governance administrations;
- (b) regularly review such recommendations to ensure they conform with changing circumstances;
- (c) mediate in and determine disputes relating to financial arrangements between the Government and subnational governance administrations
- (d) Be consulted on all legislation and regulations related to subnational finance and intergovernmental finance prior to enactment

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Art. 6 (8): Factors to Consider

IFCC recommendations should consider:

- the national interest;
- the need to ensure that the subnational governance administrations are able to provide basic services and perform functions assigned or delegated to them;
- the fiscal capacity and efficiency of the subnational governance administrations;
- economic disparities within and among the subnational governance administrations ;
- obligations of the subnational governance administrations under national legislation;
- the desirability of stable and predictable allocations of revenue shares; and
- the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria.

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Art. 6: Other IFCC-related Clauses

- Own budget
- Annual public reporting obligation by 30 June.
- May receive additional funds from development partners for research, technical assistance, other.

Art. 7: IFCC Secretariat

- To support IFCC
 - Preparing analysis
 - Preparing regulations and procedures to implement IFCC functions
- Own budget and staff

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Subnational Budgeting Options: Cambodia

By

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Designing a Fiscal Decentralization Strategy for Cambodia

Ministry of Economy and Finance
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1

D&D Strategic Framework: Goals and Basic Principles

- **Strengthen Local Democracy, through:**
 - Democratic Representation (Expanded Local Councils)
 - People Participation in Decision-Making Process
 - Public Sector Accountability to Citizen (Popular Monitoring)
- **Promote Local Development, through:**
 - Improved Public Sector Effectiveness (Service Quality and Coverage)
 - Public Sector Focus on Poverty Reduction (Especially among Vulnerable Groups)

Effective **Local Democratic Development** can assist
Poverty Alleviation

D&D Strategic Framework: Institutional Challenge

- **Need to Re-structure Subnational Governance:** to establish efficient and accountable **Unified Administrations** and **Unified Budgets** at Provincial/Municipal and District Levels
- **Need to Strengthen Subnational Administrative Capacity (Institutional and Financial)** to take over increased Service Delivery functions.

3

D&D Strategic Framework: Expected Sub-National Governance Structure

Organic Law: To Provide the Legal Framework for the New Sub-National Governance System, along the following structure:

	Province/Municipal	District/Khan	Comm/Sangkat
Local Democracy	Provincial Council	District Council	C/S Council
Functions	General Sectoral	General (Sectoral)	General (Sectoral)
Unified Administration	Yes	Yes	Yes
Own Budget	Yes	Yes	Yes
Resources	Own Revenues Fiscal Transfers	Own Revenues Fiscal Transfers	Own Revenues Fiscal Transfers

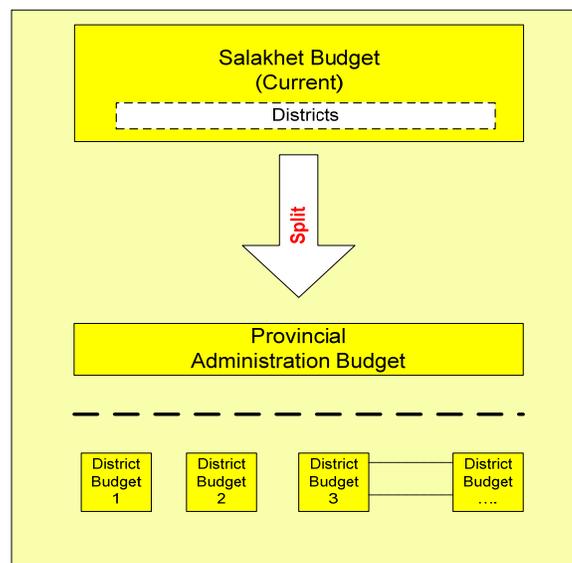
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How to Establish Subnational 'Unified' Budgets? Possible Strategy

1. Establish separate provincial and district level administration budget
 - Split off district component of the Salakhet Budget
 - Create separate provincial level and district level administration budget
2. Establish separate provincial and district level 'unified' budget
 - Identify functions to be shifted to province or district
 - Shift finances related to the function to the provincial or district level; thus, linking function-related finances to admin budget

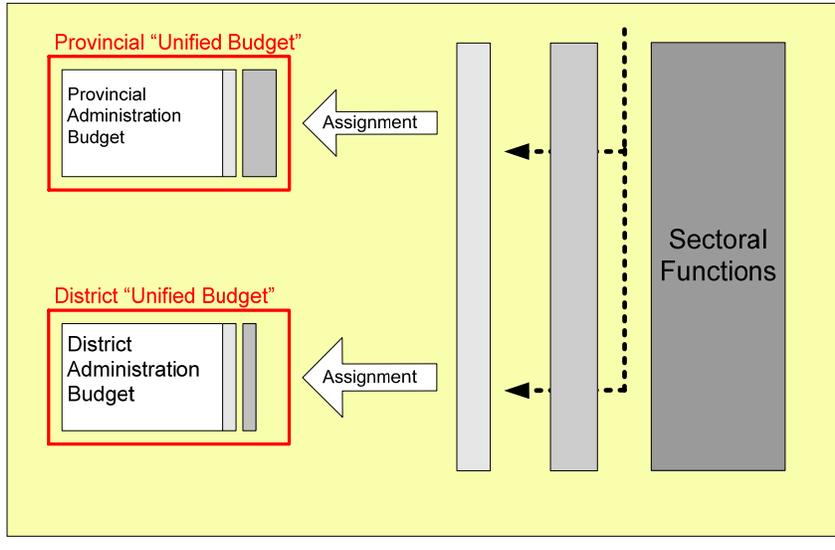
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Sub-National Administration Budget Structure: Vertical Assignment (1)

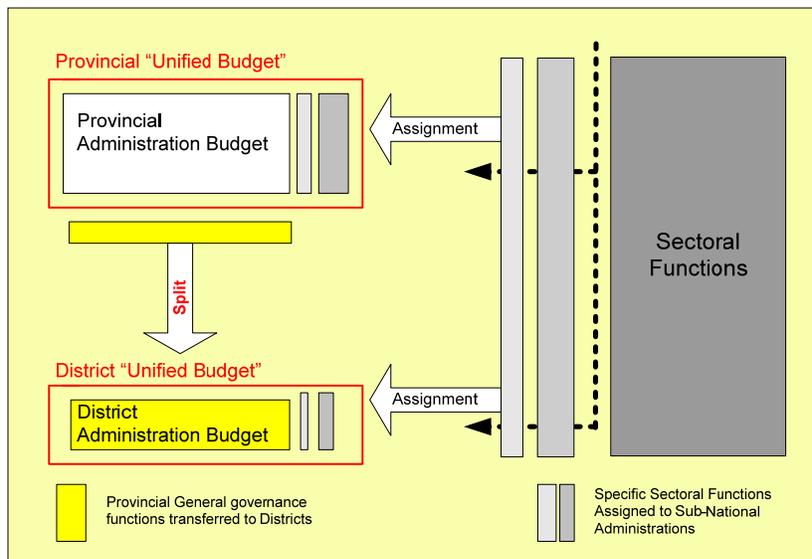


6

Sub-National Budget Structure: Vertical Functional Assignment (2)



Sub-National Governance Structure: Functional Assignment Design



System Components: Provincial Unified Budget System

1. Scope and Format
2. Responsibility for Formulation
3. Responsibility for Implementation
4. Accountability Framework
5. Transparency Requirement

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Provincial Unified Budget System: 1. Scope and Format

Budget Scope

- Provincial Assigned (devolved) Spending Responsibilities: Administrative and Services Delivery; Recurrent and Capital.
- Provincial Financial Resources: Fiscal Transfers, Own-Source Revenue, Borrowing (if Allowed)

Budget Format

- Economic Classification: Adapted from National Budget Nomenclature
- Functional (or Programme) Classification: By Type of Service Delivery Function
- District Classification (while Districts are part of Provincial Admin).

10

Provincial Unified Budget System: 2. Budget Formulation Roles

- **Provincial Administration:** Formulate Draft Budget and Annual Investment Programme **
- **Provincial Governor:** Endorse Draft Budget
- **Provincial Council[^]:** Review & Adopt Draft Budget
- **MEF/MOI[^]:** Approve Draft Budget

** Based on the Medium-term Provincial Development Plan

[^] Signifies new change to existing systems/procedures necessary

11

Provincial Unified Budget System: 3. Implementation Roles

- **Governor:** Budget Authorizing Officer
- **Provincial Administration Units[^]:** Implement Budgeted Activities
- **Provincial Tendering Committee[^]:** Oversee Procurement Process Where Required
- **MEF Provincial Department** (Financial Controller): Monitor Spending Commitments
- **Provincial Treasury:** Execute Payments Orders, Keep Accounting Records, Produce Periodic and Annual Financial Statements
- **District Governor:** Delegate Budget Authorizing Officer (if any)

[^] Signifies new change to existing systems/procedures necessary

12

Provincial Unified Budget System: 4. Accountability Framework

- **Provincial Administration** (Finance Office): Track Use of Budget Appropriations
- **Financial Controller** (MEF): Monitor Spending Commitments and Payment Orders
- **Provincial Treasury**: Accounting Controls; Periodic and Year-End Financial Reconciliation
- **Provincial Council**[^]: Assess Provincial Performance Based on Periodic Reporting by Governor, Field Visits, and Hearings
- **National Audit Authority**: Annual Audit of Provincial Budget Closing Accounts. Audit Report Forwarded to Houses of the **Parliament**.
- **MOI/MEF**: Monitor Provincial Overall Performance; Approve Provincial Budget Closing Accounts.

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Provincial Unified Budget System: 5. Transparency Requirement

- Budget Formulation and Implementation Processes clearly defined and formalized
- Periodic Reporting on Budget Performance made available **to the Public**[^]
- Approved Budget and Closing Accounts disclosed **to the Public**[^]
- **Provincial Council Meetings and Hearings open to Citizens**[^]

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System Components: District Budget System[^]

1. Scope and Format
2. Responsibility for Formulation
3. Responsibility for Implementation
4. Accountability and Transparency Framework

[^] Signifies new change to existing systems/procedures necessary

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District Budget System:

1. Scope and Format[^]

Budget Scope

- District Assigned Spending Responsibilities: General Administration and Development; Operations and Capital
- District Resources: Fiscal Transfers and Own-Source Revenue

Budget Format

- Economic Classification (Adapted from Provincial Budget Nomenclature)
- Functional Classification (Type of Service Delivery Function if any).

[^] Signifies new change to existing systems/procedures necessary

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Simplified District Budget Classification

District Budget Classification		
Code	Account Name	Explanation
Revenues		
70	Tax Revenue	Taxes assigned to district
72	District Property Revenue	Rents, concessions, royalties..
73	Sales of goods and services	User fees, administrative fees
75	Grants	Grants from higher level government (recurrent)
77	Other Revenue	74, 76 and 77 of national budget classification
13	Capital Grants	Transfers from higher level government & other agencies or individuals
Expenditures		
60	Purchase	Goods and similar
61	Services	Same as national budget classification
62	Other Costs	62, 63, 66, and 67 of national budget accounts
64	Staff Costs	Salaries and related benefits
65	Subsidies	Subsidies and Social Assistance
09	Contingency	
20	Capital Expenditures - Intangible	Design, surveys....
21	Capital Expenditures - Physical	Acquisition or development of fixed assets

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District Budget System: 2. Responsibility for Formulation[^]

- ***District's Finance Unit:*** Coordination and Finalization of Budget Document
- ***Revenue Management Units:*** Revenue Forecasts
- ***Operations Units :*** Activity Planning
- ***District Governor:*** Endorse Draft Budget Proposals
- ***District Council:*** Review and Adopt Draft Budget
- ***Provincial Governor :*** Approve Draft Budget

[^] Signifies new change to existing systems/procedures necessary

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District Budget System:

3. Responsibility for Implementation[^]

- **District Governor:** Budget Authorizing Officer
- **District Tendering Committee:** Oversee Procurement Process
- **District Finance Unit:** Monitor Spending Commitments
- **District Finance Unit:** Certify Payment Orders
- **Provincial Treasury (or District Treasury):** Process Payments, and Keep Accounting Records

[^] Signifies new change to existing systems/procedures necessary

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District Budget System:

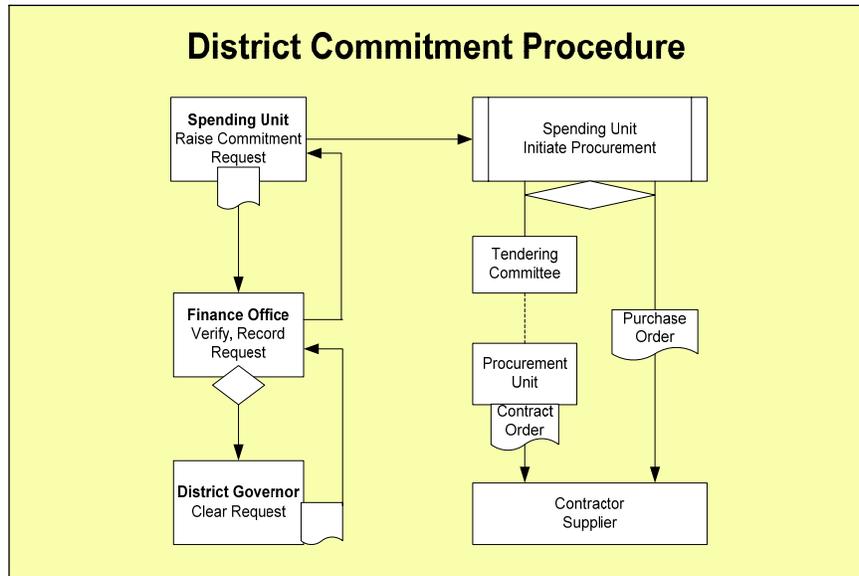
4. Accountability Framework[^]

- **District Administration** (Finance Unit): Monitor Use of Budget Appropriations
- **District Council:** Assess District Performance Based on Periodic Reporting by District Governor, Field Visits, and Hearings
- **Provincial Treasury (or District Treasury):** Accounting Controls and Periodic and Year-End Financial Reconciliations
- **National Audit Authority (or delegated to MEF) :** Annual Audit of Budget Closing Accounts
- **Provincial Governor:** Approve District's Budget Closing Accounts

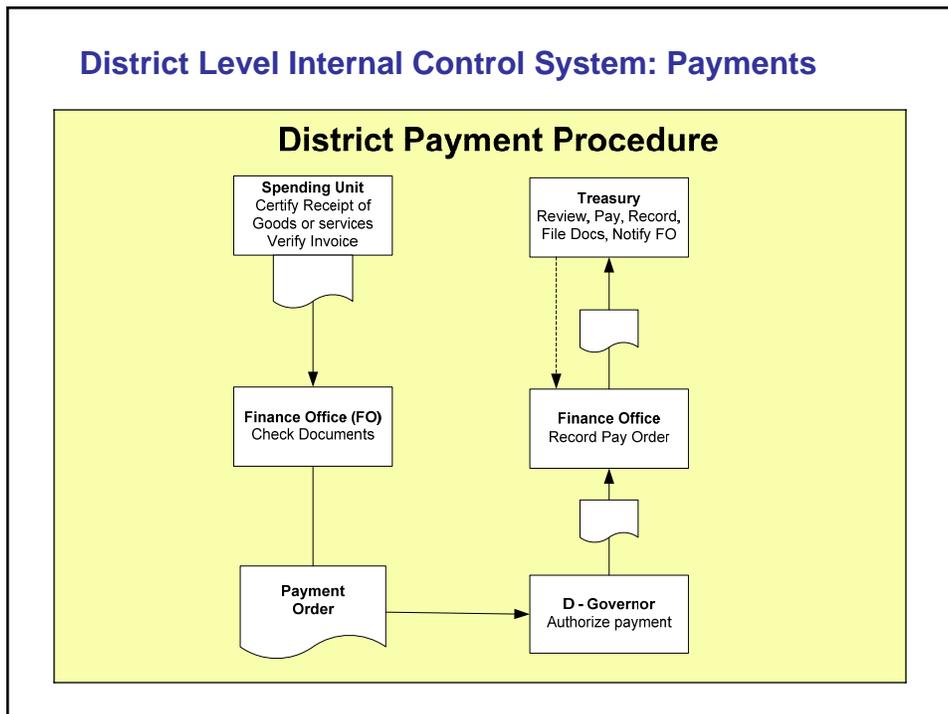
[^] Signifies new change to existing systems/procedures necessary

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District Level Internal Control System: Commitments



District Level Internal Control System: Payments



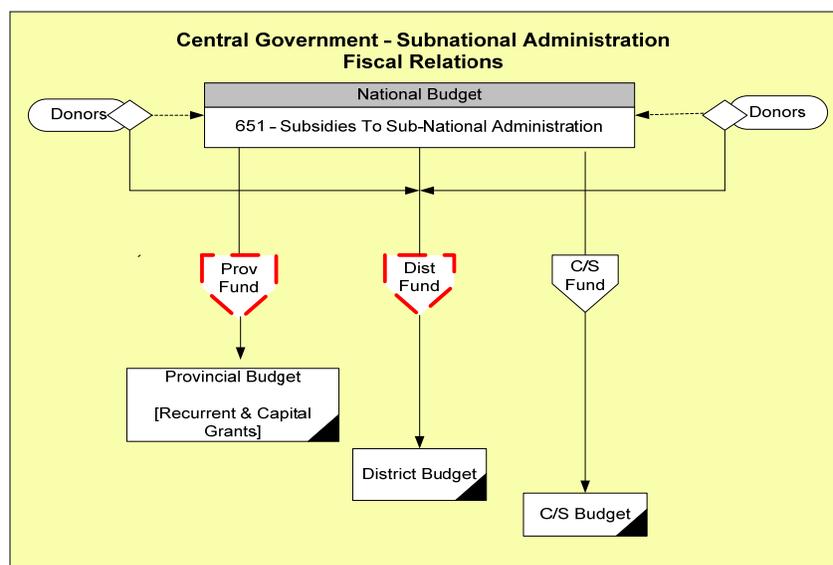
District Budget System: 5. Transparency[^]

- Budget Formulation and Implementation Processes Formalized and Known **to all Fiscal Stakeholders**
- Periodic Reporting on Budget Implementation Progress **made Public**
- Approved Budget and Closing Accounts **disclosed to the Public**
- District Council Meetings and Hearings **open to Citizens**

[^] Signifies new change to existing systems/procedures necessary

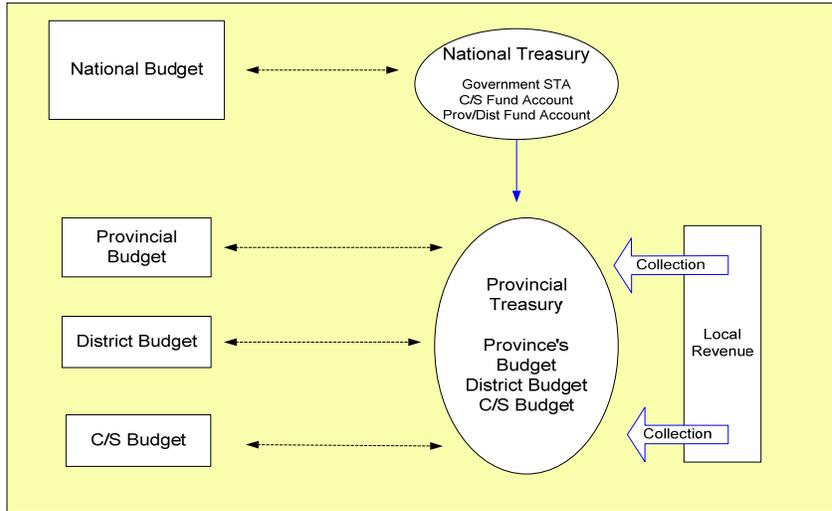
23

Inter-Administrations Fiscal Relations



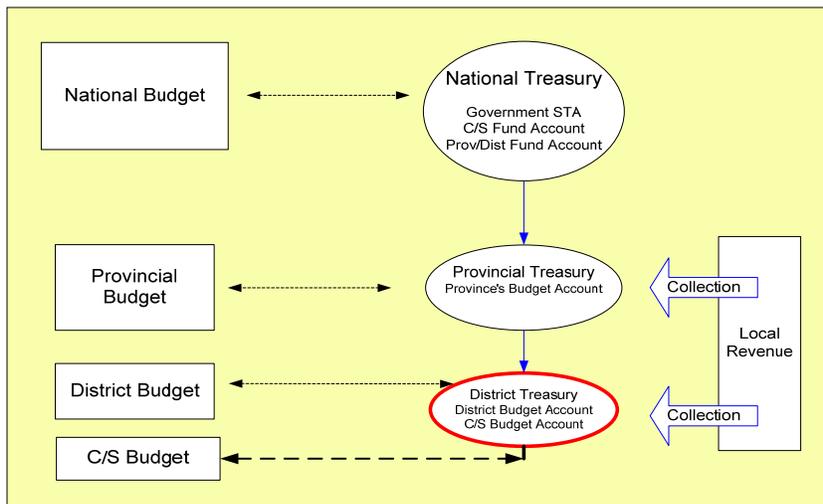
Subnational Financial Flows

Arrangement 1: Provincial Treasury



Subnational Financial Flows

Arrangement 2 w/ District Treasury Option



Way Forward

- Include subnational budgeting provisions in Budget Organic Law

Article XX: Subnational Budget System

1. Each Subnational Administration shall have own budget to reflect its assigned functions and revenues.
2. Subnational Administrations shall carry out their financial and fiscal affairs in accordance with the following principles:
 - Revenue, expenditures, and assets are to be managed in an efficient, effective manner, in the interests of the concerned Subnational Administration and its constituency.
 - The budget must reflect the spending requirements emerging from the annual investment programme and the medium term development plan.
 - The Subnational Administrations shall report on regular basis to the Ministry of Economy and Finance on the implementation of their budget.
3. The Government shall determine, by specific legislation and regulations, and in consistency with the national budget Organic Law, the sub-national budget management system.

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Way Forward

- Ensure that D&D Organic law allows for separate subnational financial system law (province, district, communes)
- Prepare (draft) Sub-national Budget Law
 - Options:**
 - Individual provincial/municipal and district budget provisions
 - Integrate subnational budget provisions (include commune level**)
- Prepare Subnational Budget transitional strategy
 - Adjust Salekhet budgets to include breakdown by district
 - Consider piloting district budgeting
 - Explore options for district payment system (treasury or bank)

**Commune level budget provisions are under an Anukret, not a Law.

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INSTITUTIONALIZING INTERGOVERNMENTAL FISCAL SYSTEMS: OPTIONS FOR CAMBODIA

Prof. Roy Kelly, PhD

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Designing a Fiscal Decentralization Strategy for Cambodia

Ministry of Economy and Finance
Royal Government of Cambodia
(2 – 20 October 2006)

INTERGOVERNMENTAL FINANCIAL FUNCTIONS

- Central-Local Grant Policy (Pool, Formula, Conditionalities)
- Local Government Finance Policy and Administration (revenues and expenditures, borrowing)
- Monitoring and Oversight (grants and/or local government finance)
- Technical Assistance / Training / Advocacy
- Implementation / Operations*

* Various Ministries involved in implementation/operations

INSTITUTIONAL OPTIONS

Who Decides?

▪ National Government

- Ministry of Economy and Finance
- Ministry of Interior
- Office of the Prime Minister

▪ Local Governments / Associations?

▪ Quasi-Independent Body

Examples: Fiscal Finance Commission / Grants Commission

Periodic: India, Pakistan

Permanent: Australia, Germany, Nigeria, Uganda, South Africa, PNG,
Pakistan Provincial Commissions

Key Issue: Need intergovernmental fiscal forum,
linked to the Ministry of Economy and Finance

3

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India National Finance Commission

- Constituted every 5 years from 1950(s)
- Focuses on central to state allocations (both tax sharing and grants)
- Independent advisory body (with 5 members)
- No permanent personnel / organization
- Secretariat provided by central government
- State Finance Commissions started [early 1990(s)]

<http://fincomindia.nic.in/>

4

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Pakistan National Finance Commission

- Constituted every 5 years from 1970(s)
- No permanent personnel / organization
- Focuses on central to provincial allocations (both tax sharing and grants)
- Chaired by Minister of Finance, with Provincial Ministers of Finance and others
- Provincial Finance Commissions started in 2002

5

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Australian Commonwealth Grants Commission

- Established 1933
- Develops state level equalization
- 5 Commissioners, 45 full time staff
- Independent, sits in Finance
- States can influence / block appointments
- Includes State level representatives

Australia: Highly Complex Formula(s)

See www.cgc.gov.au

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Germany: Financial Planning Council

- Established 1968
- Chaired by Federal Minister for Finance; with representatives from the federal, Länder, and municipal governments and the central bank. State-level (Länder) Ministers of Finance are members.
- Meets twice a year to submit recommendations for coordinating the financial plans of the Federation, the Länder, the communes and associations of communes (Section 51 HGrG).
- Recommendations based on consensus—not binding.

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Sri Lanka Finance Commission

- Established 1987 (13th Amendment to Constitution), along with local government system
- Permanent Commission
- Advises on grant allocation to provincial levels
- 5 Members: Governor Central Bank, Secretary Ministry of Finance, 3 members to represent each community (17th Amendment in 2001 established a Constitutional Council to appoint members)

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Nigeria's Revenue Mobilization, Allocation and Fiscal Commission

- Established 1990, Nigeria used multiple, ad hoc financial commissions from 1946-1990
- Became effective in 1999, linked to new Constitution
- Chaired by the Minister for Finance, with State-level Minister's of Finance as members.
- Constitutional power to monitor accrual of the federation account, determine allocation formulae, and advise states on local revenue efficiency and mobilization

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Uganda Local Government Finance Commission

- Established 1993
- Advises on central – local transfers (including equalization) & revenue mobilization
- 7 Commissioners, 28 full time staff out of 45 establishment
- Independent
- Includes representatives chosen by local governments

See www.molg.go.ug/finance_commission/index.htm

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South Africa Financial and Fiscal Commission

- Established 1994
- Advises on financial and fiscal matters to the parliament, provincial governments, and other government institutions/ministries
- Reduced from 22 to 9 Commissioners (2001); includes 3 provincial and 2 local government representatives
- 23 full time staff
- Permanent, autonomous government body.
- In early days, instrumental in mobilizing support, conducting studies, and providing an independent forum for intergovernmental fiscal relations.

www.ffc.co.za

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Papua New Guinea: National Economic and Fiscal Commission

- Established 1996
- To develop and maintain “fair, equitable and transparent intergovernmental financing arrangements that support improved quality of life for all Papua New Guineans.”
- 8 Members, from private sector or professional organizations, appointed by Minister for Finance
- 8 full time secretariat members
- Reports to Ministry of Finance

<http://www.nefc.gov.pg>

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Pakistan Provincial Finance Commission

- Established 2002
- 10 members, appointed by the Governor
 - Provincial Ministry of Finance (chairman)
 - Provincial PS Min of Local Govt, Min. of Planning, Min of Finance.
 - 3 from private sector (economics, public adm and finance)
 - 3 from local governments
- Secretariat provided by Provincial Ministry of Finance
- Reports to Provincial Cabinet and Governor
- Core Functions:
 - Determine vertical and horizontal distribution between the Government and the Local Governments
 - Make grants in aid to the Local Governments from the Provincial Retained Amount; and
 - Any other matter relating to finance for and of the local government referred to the Finance Commission by the Governor, or the Government, or by a Local Government.

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Cambodia Intergovernmental Fiscal Committee (Proposed)

- 11 Members appointed by the Prime Minister
- Members to include representatives from MEF, MOI, SNEC, Private Sector, and each governance administration. Co-opted members possible.
- Chairman is Minister of Economy and Finance.
- Power to recommend the sharing of national revenues to ensure vertical and horizontal equity. Establish conditional and unconditional grants as necessary.
- Inform parliament, government and the subnational governance administrations of its recommendations
- Mediate disputes on financial arrangements

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Institutional Support International Experience

- 1933: **Australian** Grants Commission (permanent)
- 1950s: **India National** Fiscal Finance Commissions (periodic)
- 1970s: **Pakistan National** Fiscal Finance Commissions (periodic)
- 1987: **Sri Lanka** Finance Commission (permanent)
- 1990(s): **South Africa** Fiscal Finance Commission
Uganda Local Government Finance Commission
Nigeria Revenue Mobilization, Allocation and Fiscal Commission
Papua New Guinea: National Economic and Fiscal Commission
Nepal Local Bodies Fiscal Commission
Malawi Local Government Finance Committee
India State Finance Commissions
- 2002: **Pakistan Provincial** Finance Commission
- 2007: **Cambodia?**

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International Trends / Lessons:

- Permanent Body
- Chaired by **Minister of Finance**
- Limited Members (5-11 members)
- Membership should include:
 - Ministry of Finance
 - Ministry of Interior (or Ministry of Local Government)
 - Local Government Representatives (from each level)
 - Private Sector (research institutes, universities, private sector, NGOs)
- Secretariat: Ministry of Finance

Intergovernmental fiscal relations is inherently political:
thus need membership balance, analytical independence
but linked to government to ensure adoption/implementation.

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Summary Recommendations

- Intergovernmental fiscal system should be institutionalized with an Intergovernmental Fiscal Committee under chairmanship of Minister of Economy and Finance
- Intergovernmental fiscal relations is inherently political, thus need balance in membership, independence in analysis, but linked to government to ensure adoption and implementation of policy and operations.
- Membership should include central officials from MEF and MOI, representatives of local governments, and private sector experts.
- Key role is to develop policy and operational options for grant allocation and local revenues, monitoring and oversight, dispute resolution and advocacy.
- Secretariat should be provided by MEF.

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INSTITUTIONAL SUPPORT OPTIONS FOR CAMBODIA		
Time Period	2002-2006	2007-Onwards
Reform Focus	Decentralization	Decentralization and Deconcentration
Governance Focus	Commune/Sangkat	Communes, Districts, Municipalities, Phnom Penh, Provinces
Overall Reform Implementation Support Structure	National Committee to Support Communes (NCSC) <i>Chairman:</i> Co-Ministers of Interior (8 Members)	National Committee for Decentralization and Deconcentration (NCDD) <i>Chairman:</i> Minister of Interior (8 Members)
Intergovernmental Fiscal Reform Support Structure	C/S Fund Board <i>Chairman:</i> Ministry of Economy and Finance (7 Members)	Intergovernmental Fiscal Committee <i>Chairman:</i> Minister of Economy and Finance (11 Members)
Intergovernmental Fiscal Reform	Block Grant: C/S Fund	Block Grants: Commune Fund, District Fund, Provincial Fund Categorical Grants (Education, Health, Infrastructure, ...)

DESIGNING A FISCAL DECENTRALIZATION STRATEGY FOR CAMBODIA: Course Summary

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(2 – 20 October 2006)

1

TOPICS COVERED

- Fiscal Decentralization: An Overview
- Decentralization Experience In Cambodia
- Decentralization Theory And Practice
- Allocating Expenditure Responsibilities
- Allocation Revenue Responsibilities
- Property Taxation: Structuring a Local Revenue Instrument
- Central-Local Grants
- Subnational Governance Administration: Draft Financial Provisions
- Institutionalizing Intergovernmental Fiscal Systems: Options For Cambodia
- Subnational Budgeting Options For Cambodia
- International Donor Finance: Options For Cambodia

2

FISCAL DECENTRALIZATION: An Overview

3

DECENTRALIZATION: AN INTERNATIONAL PHENOMENON

- Economic And Social Development
- Improve Service Delivery Efficiency And Accountability
- Government Reengineering, Privatization, And Decentralization
- Decentralization: Reallocating Functions And Finances Across Government Administration Levels

GREAT DIVERSITY IN EXPERIENCE

4

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WHY REFORM PUBLIC SECTOR THROUGH DECENTRALIZATION?

- **Improves Efficiency of Public Services**
 - Links mix and level of services to the local citizen demand
- **Improves Political and Financial Accountability**
 - Brings Government 'Closer to the People'
- **Improves Effectiveness**
 - Mobilizes citizen participation, innovation and ownership ('social capital')
 - Allows competition in public services ("best practices")

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DECENTRALIZATION DESIGN ISSUES

Complicated Process

- Multiple Stakeholders
- Multidisciplinary (political, fiscal, institutional)
- Multiyear (time & institutional dimensions)

Potential Problems?

- Macroeconomic instability
- Increased regional inequality and conflicts
- Declining service levels
- Increased Corruption

DESIGN AND IMPLEMENTATION STRATEGY IS CRITICAL

STRATEGY MUST BE COUNTRY SPECIFIC

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PILLARS OF FISCAL DECENTRALIZATION

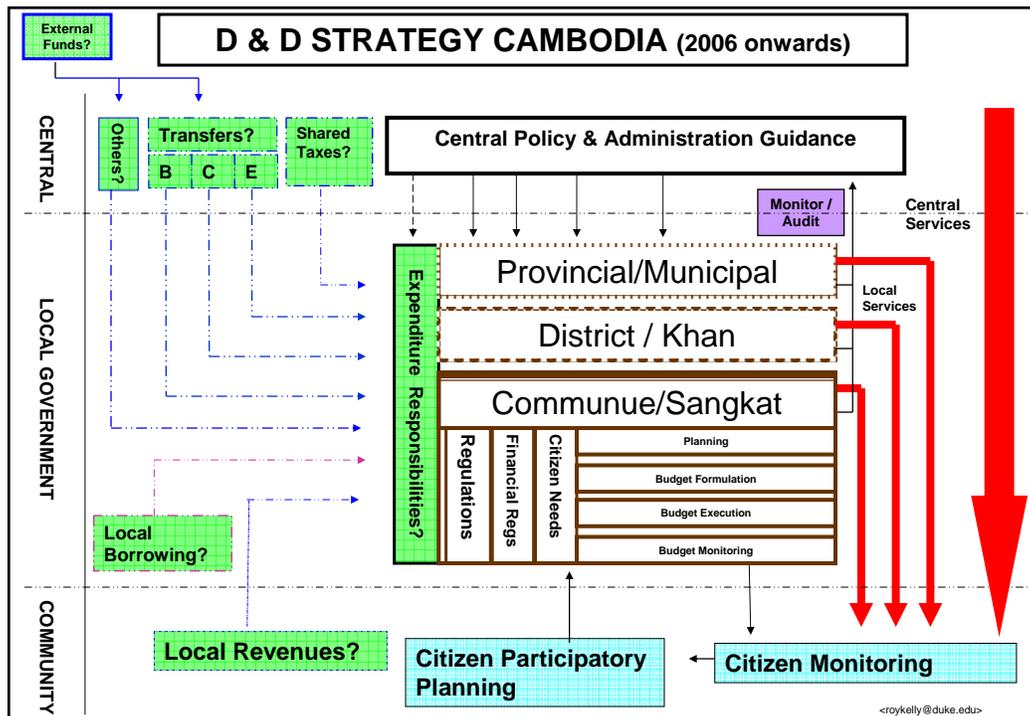
- Rationalize Expenditure Responsibilities
- Rationalize Revenue Sources
- Structure Intergovernmental Transfers
- Structure Local Level Borrowing/Debt

BUT within the context of:

- Political Will
- Legal Framework
- Institutional Structures
- Systems and Procedures
- Central / Local Capacity
- Central, Local and Community Oversight

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DECENTRALIZATION IN CAMBODIA: Decentralization and Deconcentration (D&D) Strategy Components

9

Decentralization Progress to Date

- Commune elections held in Feb 2002
- Commune/Sangkat Administration Law and related regulations established framework for expenditure and revenue responsibilities, Commune/Sangkat Fund, ...
- Planning, budgeting, financial management systems developed and tested through SEILA mechanism
- Participatory decision making, leading to implementation of development projects (approx. \$8 million annually)

Focused on Commune/Sangkat Level

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Now Broadening the Public Sector Reform to Both Decentralization and Deconcentration (D&D)

- Strategic Framework for Decentralization and Deconcentration (D&D) Reforms adopted in June 2005
- D&D strategic objectives (“**democratic development**”)
 - To strengthen **local democracy** and
 - To promote **local development** and **reduce poverty**
- D&D Components: Political, Administrative and Fiscal

Broaden Focus to include Province, District and Commune

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What is definition of Decentralization and Deconcentration (D&D) in Cambodia?

Decentralization: **assignment** of political and administrative authority to the commune level

Deconcentration: **delegation** of administrative responsibilities, decisionmaking and authority from central ministries to subnational provincial departments and/or district offices

Source: Cambodia at the Crossroads: Strengthening Accountability to Reduce Poverty, (World Bank, 2004), p. 51

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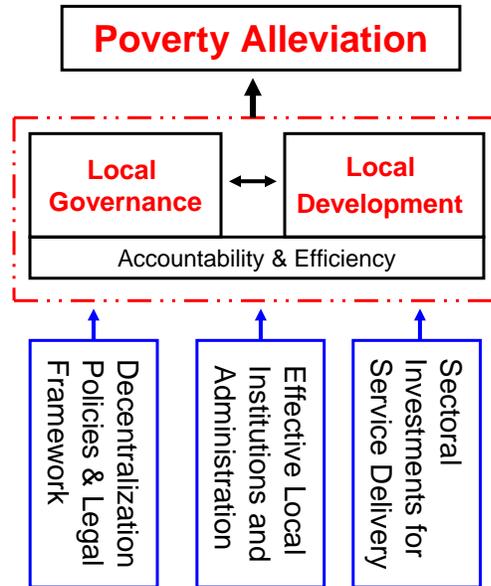
D&D National Program Components

Primary Objective:

Poverty Alleviation

Intermediate Objectives:

*To improve **Accountability and Efficiency**
Through Decentralization & Deconcentration*



**D&D National Program:
Expected Outputs**

3-Year Priorities under D&D (2005-2008)

- Enact **organic law** and revise existing legal instruments
- Establish P/M and D/K **indirectly-elected councils**
- Establish **unified administration** at P/M and D/K levels
- Establish **personnel management system** at P/M and D/K levels covering all sectoral departments and agencies
- Establish **unified budgeting** at P/M level.
- **Mobilize and allocate internal and external resources** for development & capacity building for decentralized government administrations (P/M, D/K, C/S).

Financial Aspects of D&D Strategic Framework

- **User charges** will be permitted on services delivered by all three decentralized levels
- **Own source revenues** will be granted to all three decentralized levels through a '**closed list**'
- **Collection authority** will be rationalized between the various subnational levels
- **Central-local grants** will be through **transparent formula** basis
- **Financial management systems** will be reformed at all levels to ensure accountability.

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Decentralization Reforms (2007- onwards) Broaden Focus to Provinces, Districts and Communes

- **Expenditure Responsibilities:** General developmental, limited, with specificity overtime (delegated and own functions)
- **Revenue Responsibilities:** To be assigned in law under 'closed list system' (shared and own source revenues)
- **Central-Local Transfers:** To be expanded to include all levels, a mixture of block and categorical grants
- **Borrowing:** Limited, with strict MEF approval needed

Expanded, Incremental Decentralization and Deconcentration
Priority: Should be Comprehensive to include
Political, Administrative and Fiscal

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WHAT ARE MEF CONCERNS?

- **Allocation of expenditure decisions**
 - Need to shift budgeting decisions across levels of government authorities
 - Need to shift fund flows, require system of block and categorical transfers
 - Need to shift government assets across levels
 - Need subnational budgeting, accounting and financial systems and procedures

- **Allocation of Revenue Decisions**
 - Need funds to match expenditures, thus must reallocate revenues through mixture of transfers, shared taxes, locally derived revenues
 - Need locally derived revenues to improve efficiency and accountability

- **Intergovernmental Transfers**
 - Need system of block and categorical grants, linked to expenditure responsibilities
 - Need system of managing intergovernmental fiscal system (Intergovernmental Fiscal Committee Cambodia / Fund Boards)

- **Subnational Borrowing**
 - Need policy guidelines and regulations for subnational borrowing

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Indicative D&D Implementation Plan

ACTIVITIES	2006	2007-2009				2010-2012				2013-Onwards							
Preparatory Phase																	
Organic Law Passed	XXXX																
Initial Phase																	
Establish Implementation Authority		X	X	X	X												
Establish basic structures, procedures and systems				X	X	X	X										
Transition Phase																	
Restructure basic national and sub-national functions, systems, finance, structures, and policy								X	X	X	X	X	X				
Transformation Phase																	
Further transformation into Sustainable democratic development											X	X	X	X	X	X	X

DECENTRALIZATION: THEORY AND PRACTICE

19

DECENTRALIZATION TYPOLOGY

SPATIAL DECENTRALIZATION: Diffusing urban population and activities away from large agglomerations

MARKET DECENTRALIZATION (Privatization): Shifting from government to market provision

POLITICAL DECENTRALIZATION: Shifting political power to lower levels of government

ADMINISTRATIVE DECENTRALIZATION (Rondinelli, 1983):

Deconcentration: redistribution of decisionmaking among different administrative levels within the central government

Delegation: transfer of responsibilities and power from the central government to semi-autonomous organizations not wholly controlled by the central government

Devolution: transfer of responsibilities and powers from the central government to autonomous local government administrations

Privatization: transfer of responsibilities and powers to the private sector/communities/NGOS.

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DECENTRALIZATION: Allocating Functions

What is the Role of Government?

Three Public Finance Functions (Musgrave, 1959)

- **Stabilization**
- **Distribution**
- **Allocation**

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Which Government Level should do What?

FISCAL FEDERALISM : BASIC MODEL

A. STABILIZATION

Centralized

- Monetary policy must be national
- Local economies are highly open
- Local fiscal behavior is cyclical
- Local deficit financing undesirable

B. DISTRIBUTION

Centralized

- Mobility limits local redistribution
- Inter-local resource disparities

C. ALLOCATION

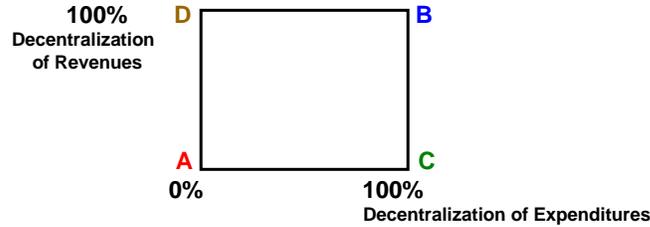
Decentralized

- Demand non-uniform across localities
- Decisions tied to resource costs
- Greater experimentation
- “Voting with the Feet” (Tiebout 1956)

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FISCAL DECENTRALIZATION MODELS



Model Description

- A** Complete Centralization
- C** Centralized Revenues and Decentralized Expenditures
- B** Complete Decentralization
- D** Decentralized Revenues and Centralized Expenditures

Model	Stabilization	Distribution	Allocation
A	+	+	?
B	-	-	?
C	+ (p)	+ (p)	+
D	-	- (p)	-

DIVERSITY IN THE REAL WORLD

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CENTRAL-LOCAL FISCAL DILEMMA

BASIC ALLOCATION DECISIONS:

EXPENDITURES: Primarily Local
 REVENUES: Primarily Central

CREATES: FISCAL IMBALANCES:

VERTICAL IMBALANCE (Between Central and Local)
 HORIZONTAL IMBALANCE (Among Local)

KEY IS:

How to combine **advantages from decentralizing major expenditures** with the **advantages of centralizing major revenue sources**?

FINANCE FOLLOWS FUNCTIONS

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DECENTRALIZATION: ALLOCATING EXPENDITURE RESPONSIBILITIES

25

FISCAL DECENTRALIZATION

The Four Pillars:

- **Allocating Expenditure Responsibility**
- Allocating Revenue Sources
- Designing Intergovernmental Transfers
- Structuring Local Borrowing/Debt

-
- ✓ Establish institutional systems and capacity
 - ✓ Mobilize political and administrative will

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ASSIGNING EXPENDITURE RESPONSIBILITIES

Financing should follow function.

BASIC PRINCIPLE:

Correspondence Principle (Subsidiarity)

To increase efficiency, public services should be provided by the jurisdiction having control over the minimum geographic area that would internalize benefits and costs of such provision. (Oates, 1972)

GOAL: Maximize Economic Efficiency

BUT: Need Capacity

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FINANCE follows FUNCTION

Why?

- To identify need for funds
- To ensure adequacy of funds (hard budget)
- To promote efficiency (type of revenues)

BUT:

- Revenues easier to decentralize
 - Expenditures decentralization: very political
 - Revenue changes less permanent
-
- Revenues can “prime” the pump (Kenya, Cambodia)
 - Revenues can force sectoral decentralization (Thailand)

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WHAT ARE THE PRINCIPLES TO CONSIDER?

- What is the benefit area of the service?
- Are there externalities (spillovers to other jurisdictions)?
- Are there economies of scale? (cheaper per unit to produce large amounts)
- What is best international practice?

OVERALL PRINCIPLE:

Correspondence Principle (Matching Costs and Benefits)

Subsidiarity principle (Administrative Capacity)

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THE CLEAR CHOICES: National vs Local Public Goods

National Public Good: National Defense, Macroeconomic stability, Distribution

Local Public Good: Municipal Services (e.g., garbage, fire services, water dist.)

THE DIFFICULTY:

- Most goods don't fit these extreme categories so nicely (e.g., education and health)
- Services must be evaluated on multi-dimensional basis (Policy, Provision, Production)
- Economies of Scale/Spillovers
- High administrative and compliance costs (definitions of local authority size and functions)
- Functional assignment may change (cost/technical constraints & citizen preferences)

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TYPICAL LOCAL EXPENDITURES

- waste collection
- markets
- bus parks/stations
- environmental management
- planning and land use regulation
- road maintenance
- water distribution
- education (nursery, primary/secondary)
- health (health clinics, regional hospitals)

Need to 'Unbundle' Service Delivery Functions:

Policy, Provision and Production

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Analytic Framework: Unpacking Service Delivery Functions

- **POLICY**: setting overall service goals, regulations, standards, norms, monitoring and evaluation
- **PROVISION**: managing finance; determining plan/budget priorities; managing budget execution; procurement; overseeing delivery & being answerable for service delivery
- **PRODUCTION**: actually designing, constructing, operating, managing and maintaining service delivery facilities

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Actor	Delivery Functions							
	Policy		Provision		Production			
	Regulation Standards	Monitoring	Planning & Budgeting	Financing	Staff Mgm.	Construction	Maintenance	Operation
Central/State Ministry								
Tier 1 LG								
Tier 1 Line Dept.								
Tier 2 LG								
Tier 2 Line Dept.								
Village Committee								
User Committee /CBO								
Frontline Service Unit								
Private Firms/NGOs								

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How to Approach ‘Finance Follows Function’?

No “best way” for expenditure allocation

Steps:

- **Assign functions** based on subsidiarity / correspondence principle, benefit area of services, externalities/spillovers, economies of scale, and best international practice
- **Establish costs** of providing minimum service levels
 - Retrospective approach: assumes current levels are correct
 - Establish minimum spending levels per capita norms (adjusted by climate / geography)
 - Establish minimum physical service standards with costing
 - Link costing to affordability
- **Transfer function, finance and functionaries**

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NEED FOR INTER-MINISTERIAL APPROACH:

SECTORAL MINISTRIES MUST BE INVOLVED

Ministry of Interior, Ministry of Economy and Finance, Ministry of Planning, CAR



ROLE for NATIONAL COMMITTEE FOR
DECENTRALIZATION AND DECONCENTRATION
(NCDD)

KEY QUESTION: How best can services be delivered?
(Central, Provincial, District, Commune, Private Sector)

Which Components to which Levels? (Policy, Provision and Production)

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**DECENTRALIZATION: ALLOCATING REVENUE
RESPONSIBILITIES**

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FISCAL DECENTRALIZATION

The Four Pillars:

- Allocating Expenditure Responsibility
- **Allocating Revenue Sources**
- Designing Intergovernmental Transfers
- Structuring Local Borrowing/Debt

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MODELS FOR REVENUE ALLOCATION

1. REVENUE SHARING (TRANSFER)

All policy, administration and revenue would be under central government control. Revenue could then be share back to the subnational governments through revenue sharing based on formula.

2. TAX SHARING (TRANSFER)

All policy and administration would be under central government control. A portion of the revenue would be given to the subnational governments based either on origin, residence or formula. (eg, transitional economies of the FSU, Vietnam, Cambodia, Laos)

3. SURCHARGES (PIGGY-BACKING)

Administration would be under central control while policy discretion would be given to the subnational governments to set a rate on the nationally-determined tax base. Revenue would then be given back to the regions based on the rate, either to origin or residence

4. CENTRALLY-ASSISTED SUBNATIONAL TAXES (CO-ADMINISTRATION)

Legislative discretion and revenue would be given to subnational governments but the administration could be shared (or co-administered) with the central government (e.g., tax base identification, valuation, assessment, collection and enforcement, appeals).

5. INDEPENDENT SUBNATIONAL TAXES

Legislative discretion, administration and revenue would be under the control of the regional government, under broad guidelines from the central government.

(McLure, 1994)

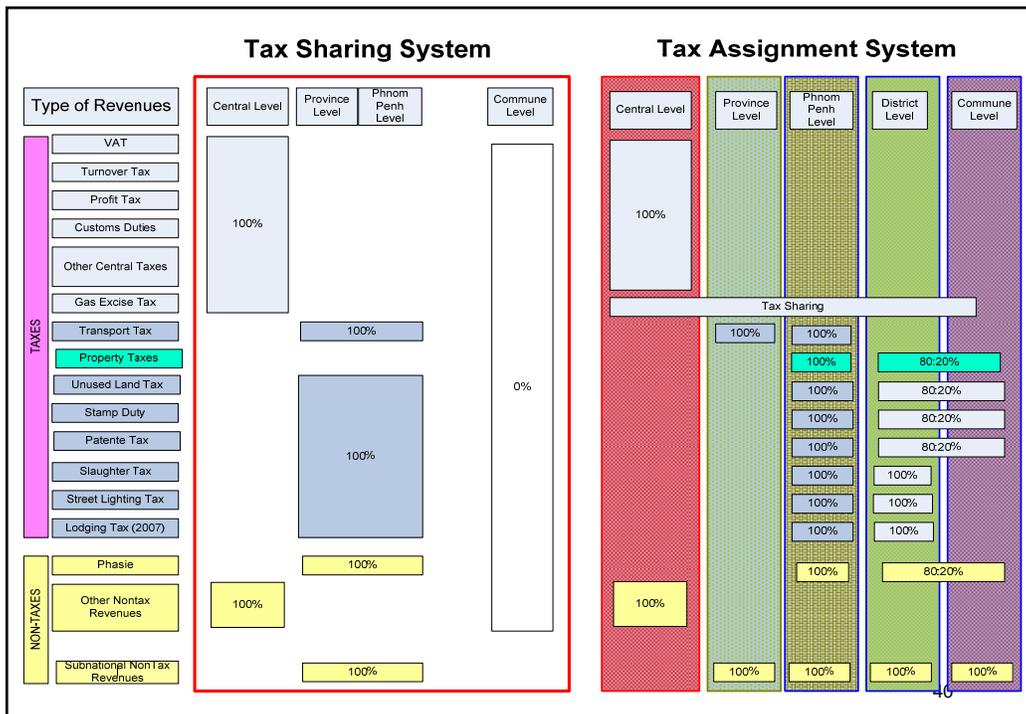
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Comparison of Revenue Allocation Approaches

Method	Advantages	Disadvantages
Revenue Sharing Grants	<ul style="list-style-type: none"> • Uniform Tax Base • Unified Administration • Equalization Option 	<ul style="list-style-type: none"> • No Choice Of Tax Base • No Choice Of Tax Rates
Tax Sharing	<ul style="list-style-type: none"> • Uniform Tax Base • Unified Administration 	<ul style="list-style-type: none"> • No Choice of Tax Base • No Choice of Tax Rate • Possible Interregional Distortions from Differential Base
Local Surcharge	<ul style="list-style-type: none"> • Local choice of tax rate • Uniform Tax Rate • Uniform Administration 	<ul style="list-style-type: none"> • No Choice Of Tax Base • No Equalization • Possible Interregional Distortions from Differential Base/Rate
Centrally-Assisted Local Taxation	<ul style="list-style-type: none"> • Local Choice of Tax Rate • Local Choice of Tax Base • Reduced Administrative and Compliance Costs 	<ul style="list-style-type: none"> • No Equalization • Possible Interregional Distortions from Differential Base/Rates
Independent Local Taxation	<ul style="list-style-type: none"> • Local Choice Of Tax Rate • Local Choice Of Tax Base • Local Control Of Administration 	<ul style="list-style-type: none"> • Duplicate Administration • Admin./Compliance Costs • No Equalization • Possible Interregional Distortions from Differential Base/Rates

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BASIC PRINCIPLES FOR TAX ASSIGNMENT

1. Taxes suitable for economic stabilization should be central.
2. Progressive redistributive taxes should be central
3. Personal taxes with progressive rates should be levied by the jurisdiction most capable of implementing a tax on a global basis
4. Lower-level governments should tax bases with **low mobility** between jurisdictions
5. Unequally distributed tax bases should be taxed at the central level
6. **Benefit taxes and user charges** should be used by all levels of government

(Musgrave, 1959)

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REVENUE OPTIONS FOR LOCAL SERVICE DELIVERY

REVENUE TRANSFERS Received by Local Governments

- Central-Local Transfers (block, categorical, equalization)
- Shared Taxes (eg, income taxes, VAT, property taxes, fuel taxes)

LOCAL OWN REVENUES Levied by Local Governments

- **Local Fees and Charges and Own Taxes**
 - User Charges and Fees/Licenses
 - Business Taxes (license / permits)
 - Property Tax and Land-Based Charges
 - Vehicle and transportation-related taxes
 - Income (payroll tax)
 - Sales (selective excise taxes)
- **Local Surcharges / Piggyback Taxes (with Local Rate Discretion)**

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ASSIGNING REVENUE RESPONSIBILITIES

Basic Principles:

- **Economic Efficiency** (Distortions & Social Welfare Costs)
- **Revenue** (Buoyancy and Stability)
- **Equity** (Benefit and Ability to Pay Principles)
- **Political Acceptability** (Stakeholder Analysis)
- **Administrative Feasibility** (Compliance & Admin. costs)

Local revenues are a **necessary** but **not sufficient** condition for effective fiscal decentralization

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ADMINISTRATION: THE CRITICAL OBSTACLE

- Problems:**
- Lack of citizen credibility
 - Lack of political will
 - Low collections
 - Weak Enforcement
 - Incomplete Revenue Base Information

Possible Solutions:

- Central Administration (e.g., property taxation in Chile)
- Co-Administration (e.g., property taxation in Indonesia)
- Local Administration (e.g., Single Business Permit in Kenya)
- Privatized Administration (e.g., mkt management in Uganda)

The key is **Revenues** and **Rate Discretion**
NOT Administration

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WHY LOCAL OWN REVENUES?

- Realizes decentralization efficiency gains
 - Promotes accountability and ownership
 - Ensures local autonomy
 - Facilitates cash flow management
 - Reduces incentives for extra-budgetary funds
-

Local own revenues require discretion (**at the margin**) in **tax rates** and **administration**.

Local own revenues are a **necessary** but **not sufficient** condition for **effective fiscal decentralization** and **improved service delivery**

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Design Principles for Revenue Systems

- **Revenue** (Buoyancy and Stability)
 - **Administrative Feasibility** (Compliance & Admin. costs)
 - **Economic Efficiency** (Distortions & Social Welfare Costs)
 - **Equity** (Benefit and Ability to Pay Principles)
-
-

Subnational Considerations:

- Does tax promote political responsibility/accountability?
- Can tax be “exported” to non-residents?
- Does tax base mobility cause distortions in location of labor and capital?
- Can tax base be identified by location (source, residence)?
- Can tax policy, structure and administration functions be vertically “unbundled”?

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Revenue Allocation: Way Forward

- Finance follows function
- Need to structure subnational finance
- Two Types: Centrally Derived, Locally Derived
- Need to determine Closed List for Locally Derived
- Closed List should include Non-Tax and Tax
- Two Questions:
 - What to include in closed list?
 - How to Structure revenue instrument on ‘closed list’
 - Tax Base, Tax Rate, Administration to maximize revenues, efficiency, and equity

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Comparison of Tax Shared and Closed List System

	CURRENT	Closed List Subnational Revenue				
Current Shared Taxes	Province	Province	Phnom Penh	District	Commune	Comments
Means of Transport Tax	X	X	X			
Unused Land Tax	X		X	X	XS	Property
Stamp Tax	X		X	X	XS	Property
Patent	X		X	X	XS	Business Premise-based
Slaughter Tax	X		X	X		User Charge
Public Lighting Tax	X		x	x		Service Charge
Lodging Tax from 2007	X		X	X	XS	Excise/Property
Property Tax			X	X	XS	Property
Phasies	X		X	X	XS	Nontax: User Charge

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Structuring Subnational Revenue Instruments

- Keep policy structure simple
- Revenue administration is the major constraint
- Depend on Tax Department but encourage local participation in administration ('co-administration')
- Give some rate discretion to local levels
 - Encourage political and financial accountability
 - Encourage a level of autonomy & ownership
 - Encourage revenue mobilization
- Encourage revenue mobilization
 - Link revenues to service delivery as possible
 - Improve tax administration
 - Improve taxpayer education

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Property Taxation: Options for Cambodia

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WHY PROPERTY TAXATION?

1. No Competition With The Central Government
2. Immobile Revenue Base (minimizes economic distortions)
3. Revenue Potential Is Good / Stable
4. Captures Benefits Of Capital Investments
5. Taxes On Ability To Pay
6. Administration Is Relatively Simple

So What's the Problem?

1. **Socially sensitive tax** (eg, importance of land)
2. **Highly Visible and Lumpy Payments**
3. **Misunderstood** (benefit vs ability to pay principle)
4. **Inequitable** (asset rich and cash poor, pensioners, etc.)
5. **Expensive to Administer** (Administrative versus Compliance Costs)

DESIGN AND IMPLEMENTATION STRATEGY IS CRITICAL

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ROLE OF PROPERTY TAXATION

Developed Countries

- **1-3 percent of GDP**
 - 2.5-3.0% Canada, US, UK
 - 1.5-2.5% NZ, Japan
 - 1.0-1.5% Aus, France, Den, Sweden
- **2-4 percent of Total Govt. Revenues**
- **40-80 percent of Local Govt. Revenues**
Over 70% Canada, UK, US, Ireland, Aus, NZ

Developing/Transitional

- **0.5 percent of GDP**
Argentina (0.9%), Chile (0.6%),
Indonesia (0.45%) Mexico (0.31%),
Nicaragua (0.13%)
- **1-2 percent of Total Govt. Revenues**
- **20-60 percent of Local Govt. Revenues**

Source: Bahl, 2002, Bird and Slack, 2004

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POLICY VARIABLES:

What is taxed?

- Define a broad base & minimise exemptions (subsidies)

How is it taxed?

- Choose basis to maximize equity at affordable administration/compliance costs

Rate structure?

- Grant tax rate discretion to local governments, within a range
- Limit effective statutory tax rates to minimize economic distortions, simplify administration and reduce compliance costs

Policy & Administrative Structure?

- Central oversight is needed for equitable implementation and possible economies of scale, combined with local involvement in property identification, valuation, collection, enforcement and taxpayer service.

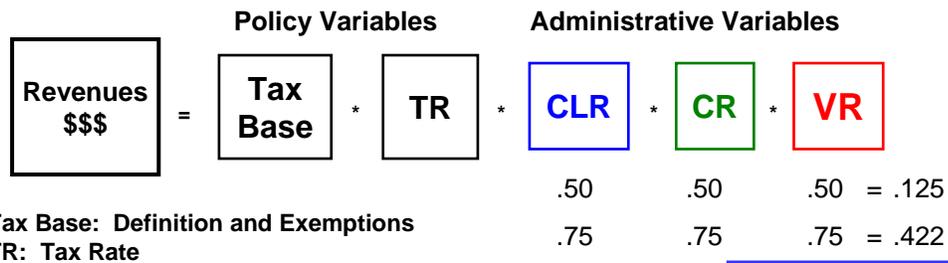
Revenues?

- Accrue to local government on derivation principle, with possible exception of non-residential property tax revenues in metropolitan areas.

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ANALYTICAL MODEL FOR REVENUE MOBILIZATION



Tax Base: Definition and Exemptions

TR: Tax Rate

Change = 230%

CLR: Collection Ratio (billing, collecting, enforcing)

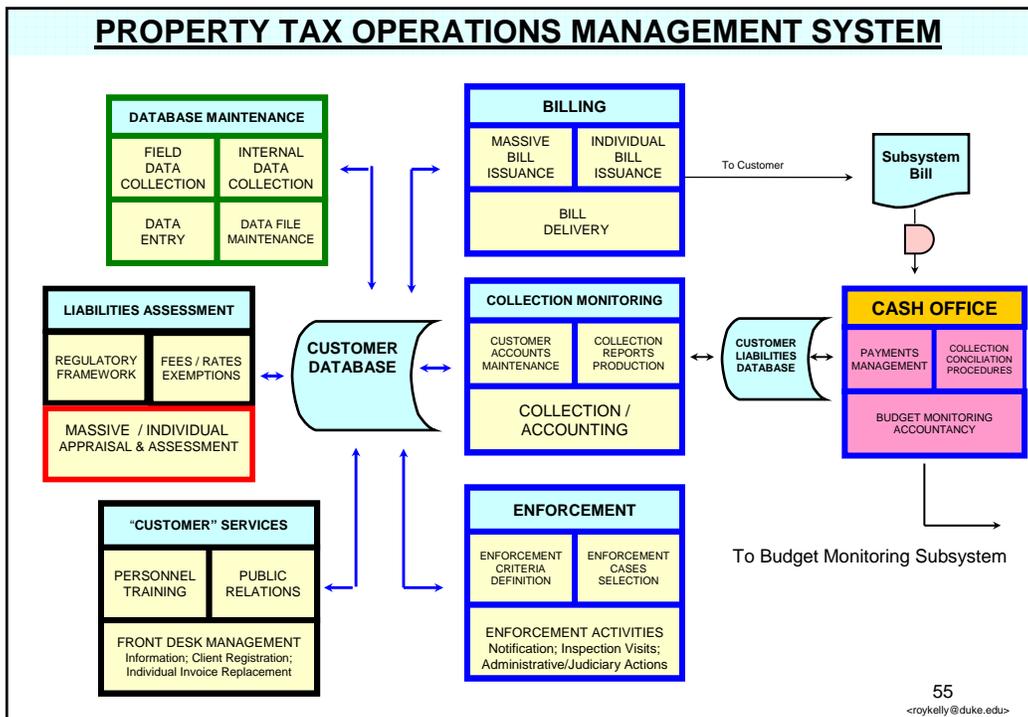
CR: Coverage Ratio (property identification, cadastre)

VR: Valuation Ratio (property valuation)

Taxpayer Service: (Collection, Coverage, and Valuation Ratios)

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CLOSING COMMENTS

- **Link property tax reform to broader decentralization reform**
 - Property tax as an 'ideal' local revenue for accountability
 - Fiscal decentralization can mobilize a broader set of stakeholders.
- **Review Property Tax Policy and Administration Strategy, Design and Implementation**
 - Keep it simple
 - Broad base and Low Rate. Minimize exemptions. Target Tax Relief.
 - Link policy and administration to evolving capacity
 - Mobilize stakeholder support (government and citizens)
 - Conduct stakeholder training to build a local level tax/governance culture
 - Ensure proper institutional and individual incentives
 - Approach property tax reform as long-term, continual process

CENTRAL – LOCAL GRANTS

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IMPORTANCE OF CENTRAL-LOCAL GRANTS

- Dominant source of revenue for subnational governments in some countries:

South Africa	85%
Indonesia	72%
Provinces	72%
Local	85%
Nigeria	67% to 95%
Mexico	70% to 90% (poorer states)
Pakistan	82% to 99%

- Design of grants affects efficiency, equity and fiscal discipline.

Source: Shah, 2002

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WHY CENTRAL-LOCAL GRANTS?

- Political Influence / Control (politics)
- Close the fiscal gap (vertical imbalance)
- Equalize fiscal capacity/needs (horizontal imbalance)
- Adjust for spillovers (externalities)
- Increase central expenditure effectiveness (merit goods)

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DESIGN CRITERIA FOR CENTRAL-LOCAL GRANTS

- Safeguard grantor's objectives
- Promote Local Budget Autonomy
- Revenue adequacy
- Simplicity and Transparency
- Predictability and Stability
- Equity and Fairness
- Efficiency (minimize distortions)
- Incentives

Source: Shah, 1994

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TYPES OF GRANTS

- **Block** (General Purpose, Lump Sum, Unconditional)
- **Categorical** (Specific, Tied, Conditional)
 - Matching vs Nonmatching Structure
 - Matching (open and close ended)
- **Cost Reimbursement**

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CENTRAL-LOCAL GRANT STRUCTURE

Key Components:

- **Size of the Pool**
(ad hoc, percentage, reimbursement basis)
- **Allocation Criteria**
(derivation, formula, cost reimbursement)
- **Distribution Approach**
(general/selective, matching & non-matching)

**Ensure Predictability, Transparency
and Accountability**

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CENTRAL-LOCAL GRANT STRUCTURE

Method of allocating total among eligible units	Method of determining total to be distributed		
	Specified share of central tax (or % of GDP/Taxes)	<i>Ad hoc</i> decision	Reimbursement of approved expenditures
Origin of collection of the tax	A	----	---
Formula	B	F	---
Total/partial cost reimbursement	C	G	K
<i>Ad hoc</i>	D	H	---

(Bahl and Linn, 1992) 63

Appropriateness of Various Grant Types

Objective	Grant Type							
	A	B	C	D	F	G	H	K
<i>Of national government</i>								
• Maintain control over local finances	-	-	-	?	+	+	+	+
• Stimulate expenditures for a particular function/overall tax effort	?	?	+	?	?	+	?	+
• Equalize services and fiscal capabilities among localities	-	+	?	+	+	?	+	?
• Increase local tax effort	?	?	+	+	?	+	?	+
<i>Of local government</i>								
• Maintain control over local finances	+	+	?	?	-	-	-	-
• Plan efficient budget	+	+	?	?	-	-	-	-
• Increase adequacy of local revenues	+	+	+	?	-	-	-	+
<i>Joint</i>								
• Minimize administrative costs	+	?	-	?	?	-	?	-

World Bank (2000) 64

THE POLITICAL ECONOMY OF GRANTS

- Prime Minister
- Parliament
- Ministry of Economy and Finance
- Ministry of Interior
- Line Ministries
- Urban Local Authorities
- Rural Local Authorities

Adapted from Bahl, 2000

DIVERSE INTERESTS: MUST MOBILIZE SUPPORT

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CLARIFY OBJECTIVE TO DESIGN SOLUTION

- Political Influence / Control
(politics—ad hoc block / categorical, matching/non-matching)
- Close the fiscal gap
(vertical imbalance—reassign responsibilities, tax sharing or general grants)
- Equalize fiscal capacity/needs
(horizontal imbalance—formula general grants)
- Adjust for spillovers
(externalities—expand boundaries to internalize, specific matching grants)
- Increase central expenditure effectiveness
(merit goods—specific matching grants)

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CENTRAL-LOCAL GRANTS IN CAMBODIA (1)

- **Need mixture** of central-local grants to achieve various objectives
- **Keep grant system simple** to promote transparency, predictability and accountability.
- **Need 'Block Grant'** for basic local functions (eg, Commune/Sangkat Fund). NEED District Fund and Province Fund
- **Need 'Categorical grants'** for specific functions (eg, roads, education, health)

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CENTRAL-LOCAL GRANTS IN CAMBODIA (2)

- **Block grants should be formula-based.** Primary basis should be population. What other factors should be included? Equal weights? Poverty Index?
- **Categorical grants should be formula-based.** Factors will depend on the specific purpose. (eg, primary education should be based on number of school age children)
- **Need Institutional Basis** to Manage/Oversee Central-Local Grant System

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INSTITUTIONALIZING INTERGOVERNMENTAL FISCAL SYSTEMS: OPTIONS FOR CAMBODIA

CENTRAL-LOCAL FINANCIAL FUNCTIONS

- Central-Local Grant Policy (Pool, Formula, Conditionalities)
- Local Government Finance Policy and Administration (revenues and expenditures, borrowing)
- Monitoring and Oversight (grants and/or local government finance)
- Technical Assistance / Training / Advocacy
- Implementation / Operations*

* Various Ministries involved in implementation/operations

INSTITUTIONAL OPTIONS

Who Decides?

▪ National Government

- Ministry of Economy and Finance
- Ministry of Interior
- Office of the Prime Minister

▪ Local Governments / Associations?

▪ Quasi-Independent Body

Examples: Fiscal Finance Commission / Grants Commission

Periodic: India, Pakistan

Permanent: Australia, Germany, Nigeria, Uganda, South Africa, PNG, Pakistan Provincial Commissions

Key Issue: Need intergovernmental fiscal forum, linked to the Ministry of Economy and Finance

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Institutional Support International Experience

- 1933: **Australian** Grants Commission (permanent)
- 1950s: **India National** Fiscal Finance Commissions (periodic)
- 1970s: **Pakistan National** Fiscal Finance Commissions (periodic)
- 1987: **Sri Lanka** Finance Commission (permanent)
- 1990(s): **South Africa** Fiscal Finance Commission
Uganda Local Government Finance Commission
Nigeria Revenue Mobilization, Allocation and Fiscal Commission
Papua New Guinea: National Economic and Fiscal Commission
Nepal Local Bodies Fiscal Commission
Malawi Local Government Finance Committee
India State Finance Commissions
- 2002: **Pakistan Provincial** Finance Commission
- 2007: **Cambodia?**

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International Trends / Lessons:

- Permanent Body
- Chaired by **Minister of Finance**
- Limited Members (5-11 members)
- Membership should include:
 - Ministry of Finance
 - Ministry of Interior (or Ministry of Local Government)
 - Local Government Representatives (from each level)
 - Private Sector (research institutes, universities, private sector, NGOs)
- Secretariat: Ministry of Finance

Intergovernmental fiscal relations is inherently political:
thus need membership balance, analytical independence
but linked to government to ensure adoption/implementation.

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Intergovernmental Fiscal Committee Cambodia (IFCC)

- Committee Members (11 members):
 - Minister for Economy and Finance (Chairman)
 - Supreme National Economic Council Chairman
 - Representative of MEF *
 - Representative of MOI*
 - Subnational Government Representatives**
 - Provincial
 - Rural District
 - Urban District (municipal)
 - Commune
 - Two Private Sector Members***
 - Secretary General, MEF (Secretary)

Co-opted Members: (eg, line ministries, private sector, others)

* Secretary of State Level

** Nominated by respective associations. MOI to nominate prior to associations.

*** Nominated by MEF, in consultation with MOI

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INSTITUTIONAL SUPPORT OPTIONS FOR CAMBODIA

Time Period	2002-2006	2007-Onwards
Reform Focus	Decentralization	Decentralization and Deconcentration
Governance Focus	Commune/Sangkat	Communes, Districts, Municipalities, Phnom Penh, Provinces
Overall Reform Implementation Support Structure	National Committee to Support Communes (NCSC) <i>Chairman:</i> Co-Ministers of Interior (8 Members)	National Committee for Decentralization and Deconcentration (NCDD) <i>Chairman:</i> Minister of Interior (8 Members)
Intergovernmental Fiscal Reform Support Structure	C/S Fund Board <i>Chairman:</i> Ministry of Economy and Finance (7 Members)	Intergovernmental Fiscal Committee Cambodia (IFCC) <i>Chairman:</i> Minister of Economy and Finance (11 Members)
Intergovernmental Fiscal Reform	Block Grant: C/S Fund	Block Grants: Commune Fund, District Fund, Provincial Fund Categorical Grants (Education, Health, Infrastructure, ...)

SUBNATIONAL BUDGETING OPTIONS: CAMBODIA

D&D Strategic Framework: Expected Sub-National Governance Structure

Organic Law: To Provide the Legal Framework for the New Sub-National Governance System, along the following structure:

	Province/Municipal	District/Khan	Comm/Sangkat
Local Democracy	Provincial Council	District Council	C/S Council
Functions	General Sectoral	General (Sectoral)	General (Sectoral)
Unified Administration	Yes	Yes	Yes
Own Budget	Yes	Yes	Yes
Resources	Own Revenues Fiscal Transfers	Own Revenues Fiscal Transfers	Own Revenues Fiscal Transfers

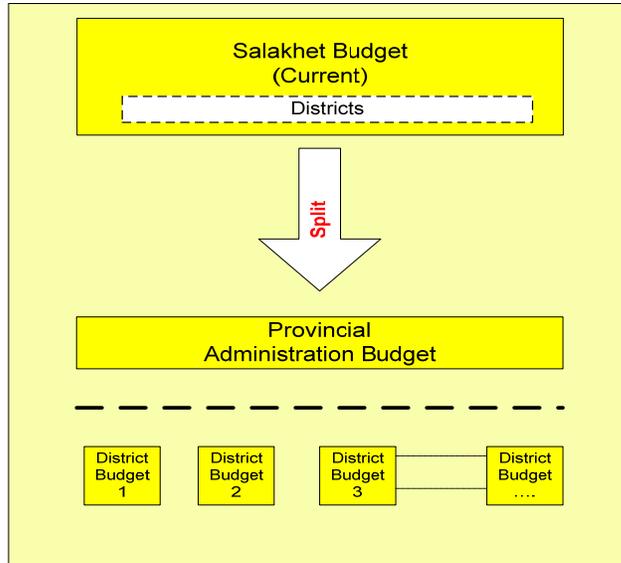
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How to Establish Subnational 'Unified' Budgets? Possible Strategy

- 1. Establish separate provincial and district level administration budget**
 - Split off district component of the Salakhet Budget
 - Create separate provincial level and district level administration budget
- 2. Establish separate provincial and district level 'unified' budget**
 - Identify functions to be shifted to province or district
 - Shift finances related to the function to the provincial or district level; thus, linking function-related finances to admin budget

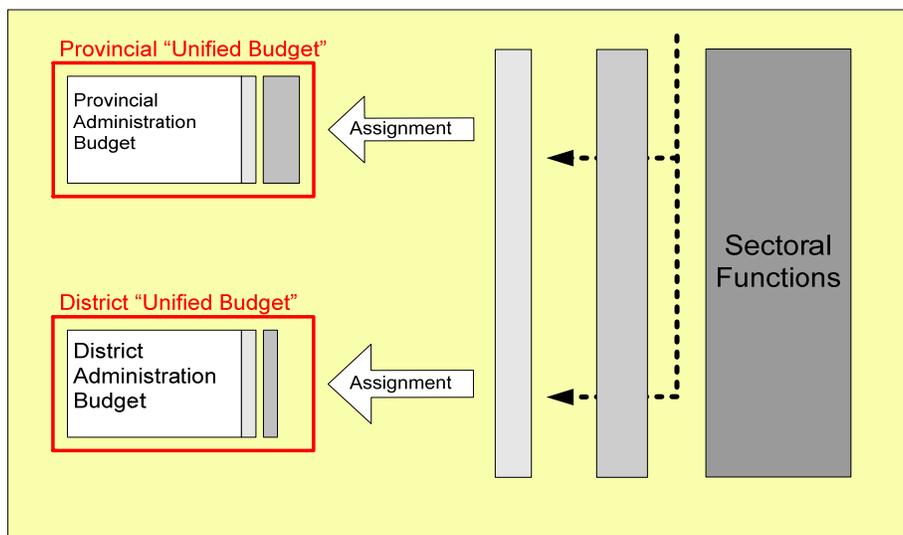
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Sub-National Administration Budget Structure: Vertical Assignment (1)



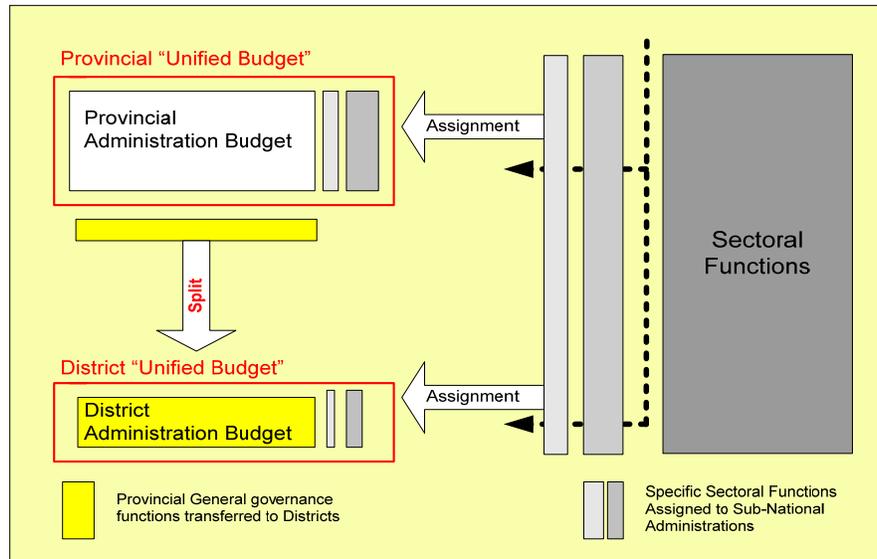
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Sub-National Budget Structure: Vertical Functional Assignment (2)



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Sub-National Governance Structure: Functional Assignment Design



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System Components: Provincial and District Unified Budget System

1. Scope and Format
2. Responsibility for Budget Formulation
3. Responsibility for Budget Implementation
4. Accountability Framework
5. Transparency Requirement

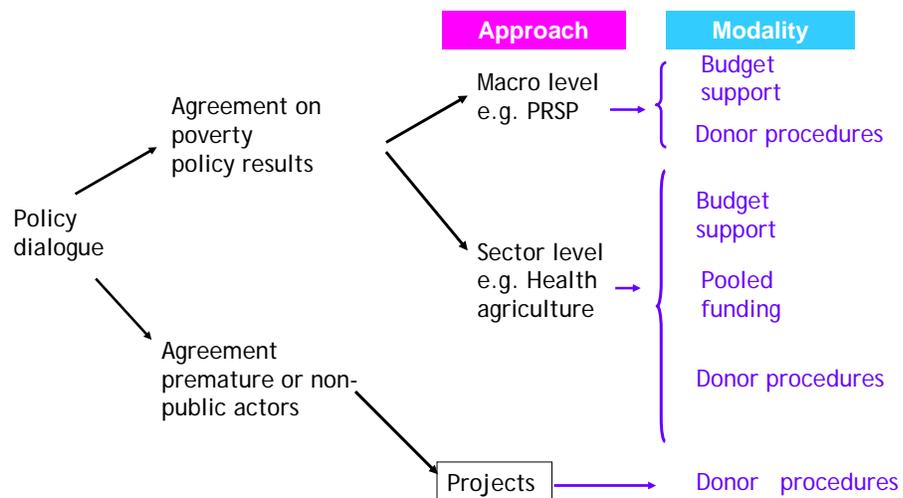
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COORDINATING DONOR FUNDING FOR D&D

Source: SWAP Training Course Rwanda

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Overview – Programme Based Approaches



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What is a 'Sector'?

- Defined by the government
- Wide to ensure coherence, narrow to limit complexity
- Fairly coherent & consistent policy
- Institutional framework
- Budget framework
- Links to macro framework

Is D&D a Sector?

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What is a Sector Programme?

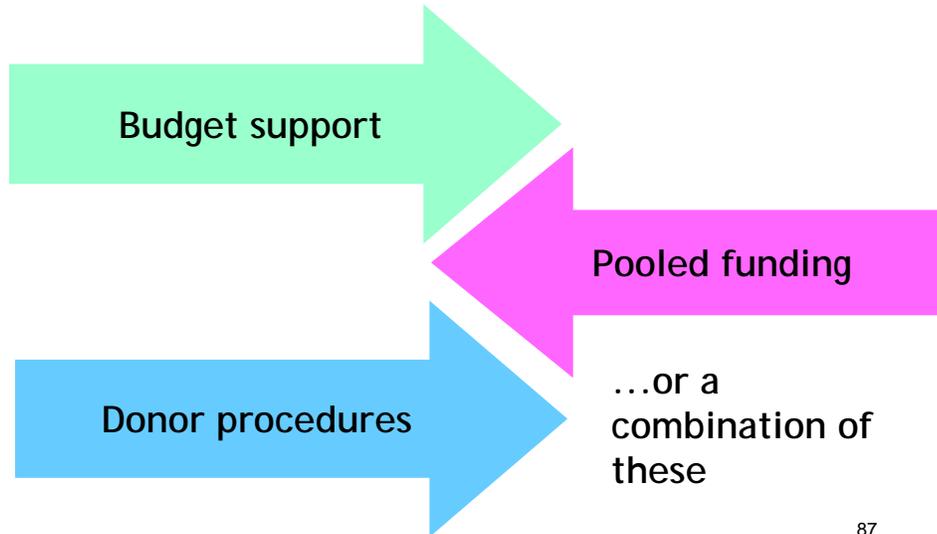
A Sector Programme is a product of the Sector Approach. It is a government (not donor) programme

Usually includes

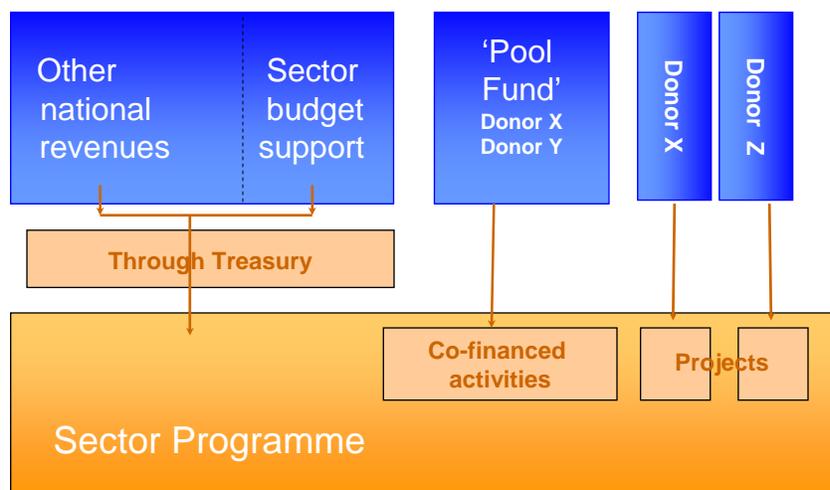
- an approved sectoral policy document
- a sectoral medium term expenditure framework (MTEF)
- a government-led donor coordination process

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Three financing modalities for support to a SP



FINANCING MODALITIES

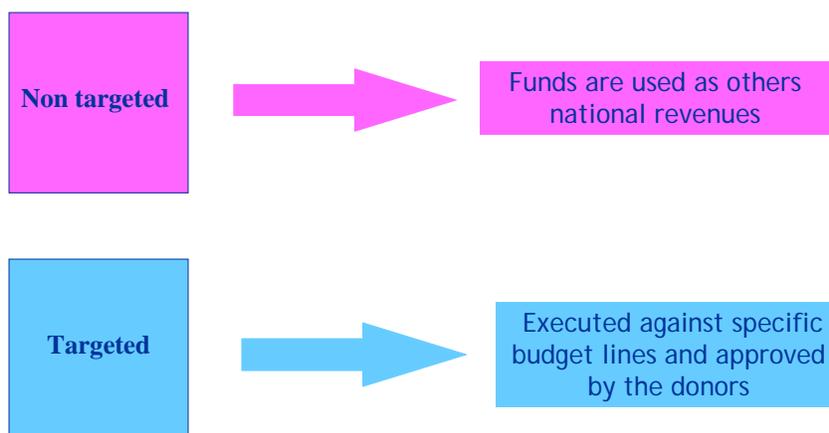


SECTOR BUDGET SUPPORT

- Transfer of resources to the budget of a partner country, uses that country's budget, financial management and procurement systems
- Monitoring set of sectoral indicators
- Dialogue with sector actors

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Budget Support can be...



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Considerations for sector budget support

- In principle, most completely aligned modality
 - Requires 'adequate' PFM
 - May undermine PRS and wider coherence
- Fear of mismanagement
 - Excessive donor focus on PFM
 - Dialogue on policies and medium term outcomes only, losing touch with ground realities
 - May add inputs without addressing capacity constraints
 - Longer term sustainability

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POOLED COMMON FUND

- Use of "third party procedures" – donor or government, if latter often with extra checks – which should strengthen systems
- By definition targeted to specific expenditure items
- Different types according to:
 - Who manages it
 - The coverage
 - Disbursement, procurement, accounting and reporting

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CONSIDERATIONS FOR COMMON POOLED FUNDING

- Only one set of procedures, as opposed to each donor using own procedures
- May accommodate safeguard concerns of donors when PFM or capacity is weak
- May focus on specific priorities (e.g. capacity development)

- May undermine wider fiscal coherence and sideline Ministry of Finance
- May be costly in transaction costs to establish/ maintain
- May create/ maintain parallel implementation structures
- May dilute legal accountability

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DONOR SPECIFIC PROCEDURES

- By mandate, only legal option for some donors and countries
- By preference of some, preferred option for small grants, technical assistance, preparatory phases, pilot activities
- By risk assessment, choice others to comply with fiduciary safeguard requirements
- By some, modality of last resort

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CONSIDERATIONS FOR DONORS' OWN PROCEDURES

- Can be adequate in building up of a sector approach
- May serve flexibly for piloting, TA, post-conflict
- May by-pass red tape and add flexibility
- Safeguard level high

- Easily undermines ownership, 'purse strings' are with donors
- Higher transaction costs
- Often less flexible
- Fragmentation of efforts
- By-passes implementation constraints rather than addressing them

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A COMBINATION OF MODALITIES?

- Often the reality, preferred or not!
- More complex for government in terms of programming and accounting

No matter the combination, all modalities can:

- Be within the multiyear budget framework and adapt to government classifications;
- Be within the sector policy framework;
- Use joint monitoring and reporting procedures
- Participate in sector policy dialogue

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“Designing a Fiscal Decentralization Strategy for Cambodia”

Participant Assessment Preparation

The following 20 general questions have been designed to focus on some major topics covered during the EFI Training Course entitled “**Designing a Fiscal Decentralization Strategy for Cambodia.**” Please prepare the answers to these questions—working both individually and with other participants. On Monday (23 October), we will choose 8 of these questions and have each participant individually answer them in writing as part of our “Program Assessment.”

1. “Macroeconomic stabilization is critically important for economic and social development, especially in Cambodia—thus, all expenditure and revenues must be centralized to enable government to achieve its stabilization, distribution and allocation functions.” Agree or Disagree. Explain.
2. “The international fiscal decentralization experience suggests that there is one uniform, correct strategy for phasing in the political, administrative and fiscal structure in Cambodia. Thus, following the Indonesian and Pakistan experience, Cambodia should follow a “big bang” approach, immediately transferring major expenditure and revenue responsibilities to subnational levels.” Agree or Disagree. Explain.
3. “The Cambodian D&D reform strategy objective is to strengthen ‘democratic development’. Thus, the government sole responsibility is to establish free and fair elections at the subnational levels.” Agree or Disagree. Explain.
4. “In contrast to most public sector reforms, fiscal decentralization in Cambodia is a relatively simple process merely involving the allocation of sufficient financial resources to the provincial, district and commune levels.” Agree or Disagree. Explain.
5. “The central government level has greater capacity than subnational levels therefore decentralization is not a good strategy for Cambodia.” Agree or Disagree. Explain.
6. “The only benefit to decentralization is to improve political accountability of elected leaders.” Agree or Disagree. Explain.
7. “The correspondence principle” argues that all government services should be carried out by the lowest level of government administratively capable of providing that service.” Agree or disagree. Explain.
8. “The RGC Strategic Framework for Decentralization and Deconcentration provides that each level of local authorities be given their own source revenues through a ‘closed list’ system. Under the ‘closed list’ system, the province, district and commune will collect and receive 100% of all revenue and be responsible to determine the tax base and tax rate for these revenue instruments.” Agree or Disagree. Explain.
9. “The D&D reform objectives of subnational democratic development will be achieved and completed following the commune-level direct elections in 2007 and the indirect elections for the district and provincial levels.” Agree or Disagree. Explain.

10. "The Ministry of Economy and Finance should decide on a clear allocation of functional (expenditure) responsibilities between the central, provincial, district and commune level before they assign revenue instruments or establish central-local transfers." Agree or Disagree. Explain.
11. "Property taxes and customs trade duties are ideal local level revenue instrument since the tax bases have low mobility and tend to reflect the value of locally provided services." Agree or Disagree. Explain.
12. "Local own source revenues are only important in order to force locally elected leaders to be more accountable to their citizens. Those that have the privilege to spend the local budget should be forced to share the political burden of levying and collecting at least a portion of the revenues." Agree or Disagree. Explain.
13. "To increase autonomy and accountability, locally elected leaders should be given the power to choose their own tax rates for local revenue instruments without any government interference." Agree or Disagree. Explain.
14. "All grants are purely political allocations aimed at making subnational level administrations dependent on and controllable by the central government. As such, they serve no useful social objective and should be abolished. Subnational level administration should depend only on revenues derived from their "closed list" for financing their functions." Agree or disagree. Explain.
15. "Giving local own source revenues will only increase the horizontal inequality between local governance administrations. The rich local authorities will get richer and the poor local authorities will remain poor. Thus, Cambodia should continue to depend on its system of tax sharing based on the derivation principle." Agree or disagree. Explain.
16. "Grant formula(s) are inherently very political, thus Cambodia should avoid using formula-based grants and rather depend on the detailed, individualized amounts for each local authority as recommended by the Ministry of Interior." Agree or disagree. Explain.
17. "Cambodia should limit the central-local grant system to one type of grant to ensure simplicity while closing the vertical fiscal gap, horizontal equality, adjustment for spillovers and improved effectiveness of national spending priorities. Agree or disagree. Explain.
18. "Cambodia needs an intergovernmental fiscal committee, headed by the Ministry of Economy and Finance, to guide central-local grant policy. This committee should be limited to the Ministry of Economy and Finance, Ministry of Interior and the Line Departments." Agree or disagree. Explain.
19. "Provincial, district and commune level budgets and financial management systems in Cambodia should require the establishment of a "financial controller" to control commitment expenditures." Agree or disagree. Explain.
20. "Donors agree and are currently channeling their funding for decentralization through the government financial system (on-budget) to achieve the PFM objectives." Agree or disagree. Explain.