POLICY BRIEF 2022

CAMBODIA: STRENGTHENING INTERGOVERNMENTAL FISCAL ARCHITECTURE FOR IMPROVED SERVICE DELIVERY

Key Messages

The Royal Government of Cambodia (RGC) has made a commitment to continuously improve public service delivery by bringing government closer to people through Decentralization and Deconcentration (D&D) reforms. Under D&D reforms, responsibilities for providing government services are being shifted to Subnational Administrations (SNAs), including the commune/Sangkat (CS), district and municipal (DM), and capital and provincial (CP) administrations. Strengthening the ability of the SNAs to deliver public services is key to the success of this reform agenda. A recent report on "Cambodia Intergovernmental Fiscal Architecture" recommends the followings:

1- Better coordination of D&D reforms with National Program for Public Administration Reform (NPAR) and the Public Financial Management Reform Program (PFMRP) to transform SNAs into efficient public service providers.

2- Providing clarity to key concepts/terms used including "unified administration" at DM level and the difference between "permissive" and "obligatory" functions.

3- Further deconcentration of budgets of important service delivery ministries to SNA level to support improvements in public service delivery. While the delivery of major social services such as education and health are among the most deconcentrated, other important services remain fiscally centralized.

4- Increasing the subnational share of public expenditures. The allocation of the DM budgets increased in absolute terms since 2017 but accounts for only around 10 percent of total SNA budgets, despite being seen as becoming the primary subnational level for service delivery.

5- Adjustments in the structure of the intergovernmental transfer systems as more functions are assigned and more funds are made available to SNAs.

6- Further strengthening subnational PFM systems and practices as D&D reform moves forward.

The study also recommends providing more local discretion on decision-making, better defining roles for service delivery at the DM level, and clarifying budget procedures for transferring funds from line ministries to DM administrators.

Context

While the centralized model of public administration and public financial management (PFM) systems were well suited to the development objectives of Cambodia in the past, there is an urgent need to improve the subnational PFM systems and practices to fit the direction and pace of ongoing reform efforts.

Despite delays due to the impact of COVID-19 on government operations, the RGC is still firmly committed to implementing key reforms. In 2019, the Subnational Administration Budget System Reform Strategy (SNA-BSRS) was adopted to improve and simplify expenditure procedures and accountability at the Subnational level. In 2021, the RGC also adopted the National Program for Subnational Democratic Development (NP-SNDD) Phase 2, which emphasizes the role of effective SNA planning and strong PFM systems for fiscal decentralization.

It is essential to achieve an improved harmonization across cross-cutting reforms (D&D, PFMRP, and NPAR) to advance the reform agenda for improved service delivery, including coordination with NP-SNDD Phase 2 and the SNA-BSRS activities. Specifically, joint action plans and monitoring and evaluation (M&E) frameworks need to be established across these reforms. In addition, there needs to be sufficient coordination between the SNA-BSRS, the overall Budget System Reform Strategy (BSRS), Public Investment Management Reform Strategy, Public Procurement System Reform Strategy, and Revenue Mobilization Strategy.

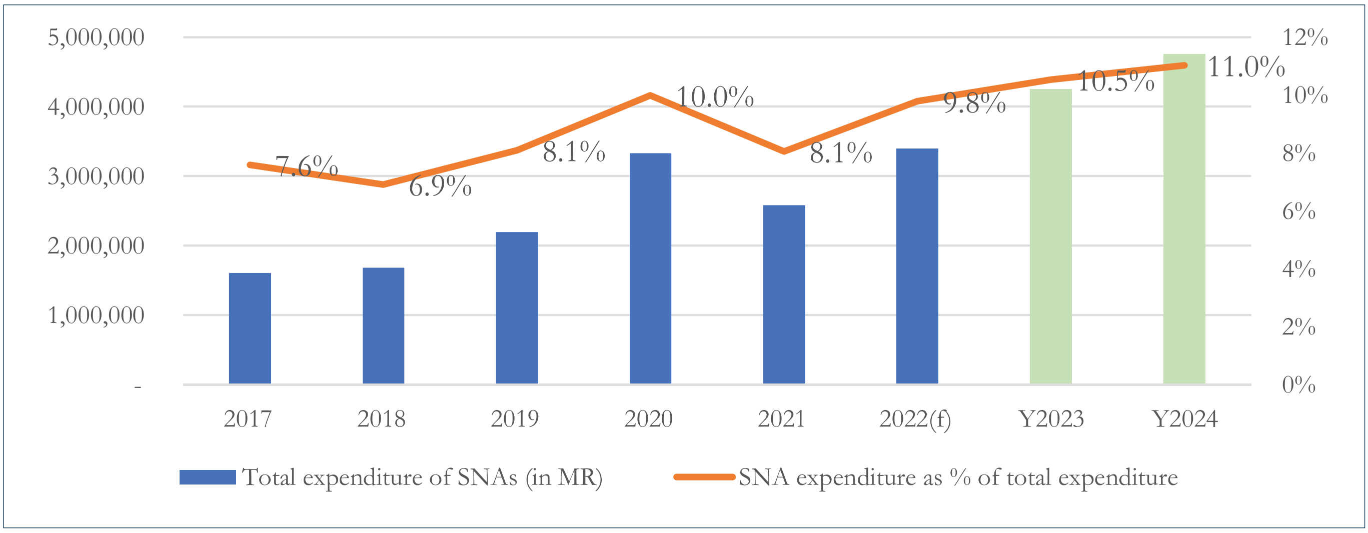
The starting point for establishing coherence to intergovernmental fiscal architecture is to provide clarification to the assignment of service delivery responsibilities. All three tiers of SNAs have been assigned obligatory and permissive functions without

Australian Aid
EUROPEAN UNION
WORLD BANK GROUP

explaining the difference between them. In addition, these functions need to be explicitly articulated at the DM level to allow the cost estimations needed to perform the functions effectively.

After providing clarity to service delivery responsibilities, attention should shift to further deconcentration of service delivery budgets and providing more financing for them. In terms of financing, the RGC has made good progress in shifting resources to SNAs (see Figure 1) increasing funding four-fold, from US $190 million (6.1 percent of total government expenditure) to US $821 million (10 percent of total) between 2013 and 2020.

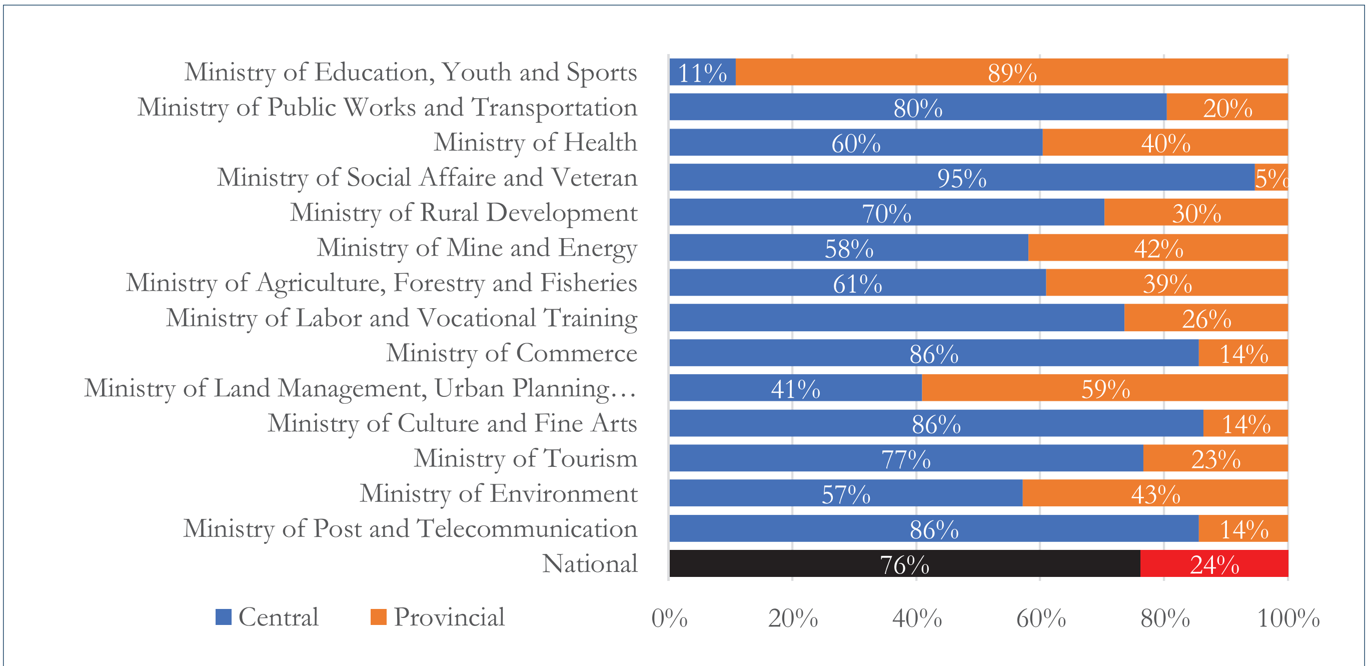
Figure 1: SNA expenditures in million riels and as % of total government expenditure (2017-2024)



Source: MEF (2019, 2020, 2021) Budget in brief for 2019, 2020, 2021 and 2022.

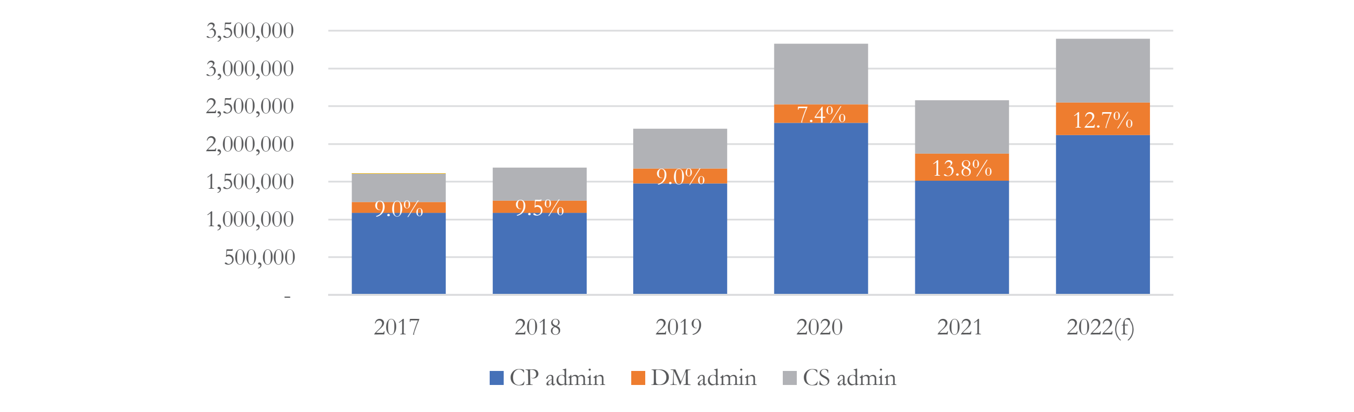
However, important service delivery ministries remain fiscally centralized. Overall, around three-quarters of line ministry (LM) budgets are executed at the central level (see Figure 2). While the Ministry of Education, Youth and Sports (MoEYS) execute 89 percent of its recurrent spending at the subnational level, this share in the Ministry of Health is only 40 percent. Although some other smaller ministries, such as Land Management, Urban Planning and Construction, Environment, and Mines and Energy, are also relatively deconcentrated, there are large ministries that remain fiscally centralized, among them: Public Works and Transportation; Social Affairs, Veterans and Youth Rehabilitation; and Rural Development.

Figure 2: Central and provincial share of sector budget, 2019



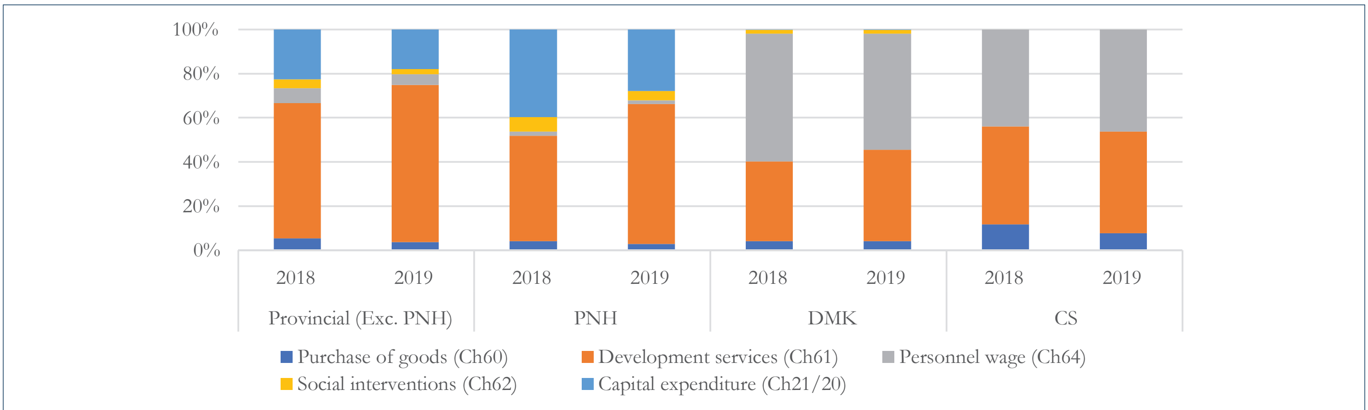
There is a fiscal imbalance among the three tiers of the SNAs. The CP level accounts for a clear majority, while the DM level accounts for the smallest share (see Figure 3). The allocation of the DM budget increased in absolute terms since 2017 but accounts for only around 10 percent of total SNA budgets, despite being seen as becoming the primary subnational level for service delivery.

Figure 3: SNA budget for each tier and % of DM budget (2017-2022)



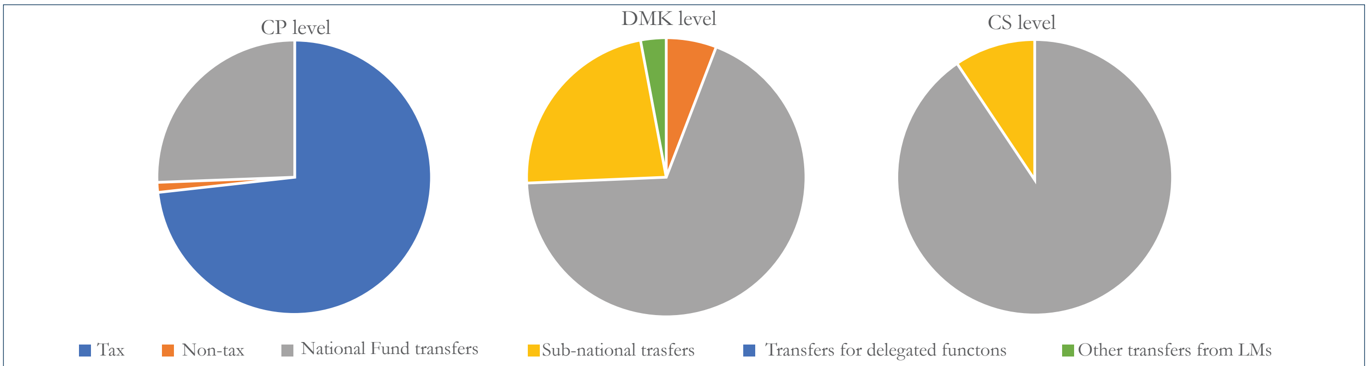
In addition, DM (and CS) budgets are dominated by wage and salary spending (Chapter 64) whereas development spending (Chapter 61) is a small share of their total budget (see Figure 4).

Figure 4: Expenditure by SNA; share of total, 2018 and 2019



The intergovernmental financing arrangements, which include the transfer system and own-source revenue assignment, will require adjustments as more functions are assigned to SNAs. At least four central government fiscal transfers are currently available to SNAs: national fund transfers, subnational transfers (through revenue sharing), conditional transfers (for delegated functions), and other transfers from line ministries (LMs). However, it is not clear if the transfer system addresses vertical and horizontal fiscal imbalances. National fund transfers are by far the most important for the CS and DM levels (see Figure 5). Conditional transfers presently play a small role in intergovernmental fiscal relations, though they are expected to grow in importance as more functions are transferred.

Figure 5: Financing mix of SNA levels; share of total revenue, 2019



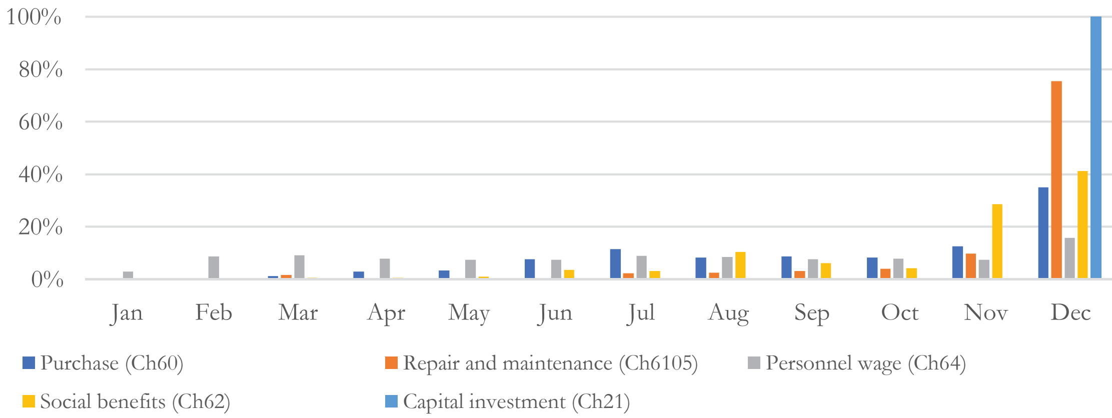
Source: MEF

In terms of reforming the intergovernmental financial system, a second major challenge is the limited progress in subnational own-source revenue generation. Currently, only the CP level has been assigned tax revenue. Further, the eight centrally assigned taxes to the CP level are akin to a shared tax rather than a purely own-source of revenue.

Public financial management at SNA level

The current subnational PFM system is inadequate to facilitate achieving results from D&D reforms. Bunching up of budget execution at year end, especially for repair and maintenance (Ch 6105) and capital spending (Ch 21), suggest some key challenges with PFM processes (see Figure 6). A sustained effort to address PFM related process challenges and to improve the PFM capacity at subnational level is needed.

Figure 6: Monthly budget execution for DM; share of the total budget, by budget items, 2019



Source: MEF

The successful implementation of SNAs' development plans and program-based budgets requires effective coordination between the Ministries of Economy and Finance, Interior and Planning, and the National Committee for Subnational Democratic Development (NCDD). The SNA-BSRS lays out a clear vision for improving the PFM systems and practices of SNAs, but certain key areas should be given more priority. For the CP level, those include: (i) defining rules for the management and recording of national subsidy, horizontal budget re-allocation and carry-forward surpluses; (ii) strengthening the implementation of program-based budgeting; and (iii) addressing specific gaps and inconsistencies in the use of Chart of Account codes related to the national transfer. For the DM and CS levels, the primary issue is the need to provide them with timely estimates of national and subnational transfers to support their preparation of annual plans and budgets.

Recommendations to improve intergovernmental fiscal architecture

Issue	Short-term options (1-2 years)	Longer-term options (3+ years)
Preparation and implementation of NP-SNDD Phase 2	• Establish strong coordination mechanisms between the D&D reform and the PFMRP.	• Ensure effective implementation of the NP-SNDD Phase 2.
Addressing vertical and horizontal fiscal imbalances	• Review the transfer mechanisms for all three levels of government. • Use a rules-based approach for fiscal transfers to the CP level.	• Address the adequacy of funding to subnational levels by estimating vertical fiscal imbalances. • Ensure that conditional transfers complement the objectives of functional assignments to SNAs.
Improving Subnational PFM systems and practices	• Strengthen the budgeting system at the CP level. • Address inconsistencies in the use of the Chart of Accounts. • Introduce new budget line items to record budgetary resources for conditional transfers for delegated functions and assigned functions. • Provide the SNAs with a timely estimate of national and subnational transfers to support the preparation of annual plans and budgets.	• Strengthen the implementation mechanisms for SNA-BSRS, especially as it relates to improving the link between planning and budgeting. • Improve the coordination mechanism between MEF, MoI, MoP and NCDD for the preparation and implementation of program-based budgets (PBB) in the SNA-BSRS.
Transfer of functions to the DM level	• Issue guidelines to clarify the responsibilities between DM administration staff and technical line offices. • Develop a methodology to estimate the cost of operational and functional expenditures associated with the newly transferred functions. • Review the guidelines on the management of non-tax revenues to improve flexibility and efficiency. • Improve the functioning of OWSOs by deploying ICT technologies, especially for revenue collection.	• Delegate HR management responsibilities to the SNA level. • Develop and implement a capacity building strategy for the DM administrations. • Review legal framework on the transfer of budgetary resources to address inconsistencies.