

Chapter 7

Public Financial Management Reforms

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“Finally, as the head of the RGC, I would like to encourage the Ministry of Economy and Finance to rigorously and firmly lead this reform program toward achieving our expectation. ... Therefore, I would like to appeal to government officials at all levels who are involved in public financial management both on the revenue and expenditure sides to actively participate and share responsibility for implementation of this work ... so that we will be able to achieve a stable and strong public financial management system with transparent and clear accountability...” **Samdech Prime Minister Hun Sen**, Keynote Address at the Formal Launch of the Public Financial Management Reform Program at Government Palace, 05 December 2004.⁴⁴

“Money is fungible. Hence, in a country where corruption is widespread, foreign aid flows could nurture corruption as they substitute public resources in providing public goods and services, making it easier and less conspicuous for public assets and revenue to be misdirected to non-public use. Hence, corruption, and more generally governance, does matter in Cambodia where foreign aid flows account for 12 to 13 percent of GDP.” Statement by **Mr. Il Houn Lee, Deputy Division Chief, Asia-Pacific Department, IMF**, at the Consultative Group meeting in Phnom Penh, December 6, 2004.

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Public financial management reforms have been part of the government's reform programs for the last half-decade, with repeated calls for almost the same action plan. In various letters of intent to the International Monetary Fund (IMF), and at every Consultative Group (CG) meeting, the government has committed to taking measures to increase both revenue and expenditure to social sector.

7.1. Revenue Mobilisation through Customs and Taxation Reforms

Before the inception of the governance action plan (GAP) adopted in 2001 following the Consultative Group Meeting in May 2000, most of the government reform agendas were based on many premises such as the annually agreed CG benchmarks between the government and the donor

⁴⁴ Full keynote address is available at <http://www.cnv.org.kh/>

community, the “Triangle Strategy 1998”, and the Interim National Strategy for Poverty Reduction. Noticeably, in the “Cambodia Enhanced Structural Adjustment Facility Medium-Term Economic and Financial Policy Framework Paper, 1999–2002,” prepared by the Cambodian authorities in collaboration with staff of the International Monetary Fund and the World Bank, and dated October 6, 1999⁴⁵, the government committed to fully implementing the remaining provisions in the 1997 Law on Taxation, strengthening the administrative capacity to collect taxes and arrears, and further broadening of the revenue base and anti-smuggling initiatives. Revenue was set to reach 12.75 percent of GDP by the end of 2002⁴⁶ through various committed measures to reform its revenue collection institutions, i.e. the Customs and Tax Department, and other non-tax revenue-generating ministries.

To meet its targets, the government strictly implemented and monitored the exemptions of tax and duty provided under the Law on Investment. Pre-shipment inspection was reinforced to avoid import revenue leakage. The VAT base and coverage were extended. Tax arrears and compliance were strictly reinforced. The December 1997 Prime Ministerial Order for the transfer of revenue collected by line ministries to the Treasury and Ministry of Economy and Finance was reinforced, including the collection of proceeds from the sale and lease of state assets and garment quota auctions. Following the fourth CG meeting in Paris in 2000, the government has introduced the GAP, comprised of short and medium-term actions, to fulfil its commitments. The quantitative benchmarks for public financial management reforms in the following CG meetings were based on previously set indicators.

The actual results have been mixed (See Box 7.1 for recent developments). Though many administrative actions were implemented as promised, some short-term actions (within one year) have been delayed. The Law on Customs is still pending in the National Assembly, and amendment of the Law on Investment and Taxation was only adopted in 2003. However, the introduction of Value Added Tax (VAT) in 1999 resulted in a revenue increase of 40 percent compared with the revenue collected in 1998. Non-tax revenues, such as tourism (visa fees, Angkor Wat entrance fees), post and telecommunications, leasing and selling of state assets, and other concessions have not been granted in a transparent manner

⁴⁵ Available at <http://www.imf.org/external/np/pfp/1999/cambodia/index.htm>.

⁴⁶ 2002 Cambodia Consultation Group meeting, Priority Areas for Joint Monitoring. This was also the benchmark of previous CG meetings based on the Financial Policy Framework Paper 1999–2002.

with proper bidding, which has lead to revenue leakages. Therefore, the government has barely hit its public financial targets since then.

The EIC estimates that the revenue share of GDP rose from 8 percent of GDP in 1998 to 10.2 percent of GDP in 1999, and to 11.2 percent in 2002, before falling back to 10.4 percent in 2003, due largely to political uncertainty surrounding national elections in July 2003 and anti-Thai riots in Phnom Penh in January of that year. So the government has failed to increase its revenue to about 13 percent share of GDP by 2002, the benchmark of CG6. The revenue target for the fiscal year 2004 was set at 11.9 percent of GDP. But again, data released by the Ministry of Economy and Finance (MEF) reveals that this target is hard to achieve.

Overall performance of public financial management was marked “unmet” by the donor community at the recent CG7 meeting held on December 6, 2004. The reasons behind these poor performances are simply seen as due to a lack of commitment and political will.⁴⁷

Box 7.1: Recent Developments in Public Financial Management Reforms

Progress	Remained Issues
▪ Strengthening Capacity of Tax and Custom Department, anti-smuggling, pre-shipping, and computerization. ▪ Amendment Law on Investment and Taxation; Preparation of Custom Law. ▪ Introduction and expansion of Medium Term Expenditure Framework. ▪ Establishment of National Authority of Auditing ▪ Application of Procurement to all ministries but royal palace.	▪ Failures to achieve targeted budget revenue and expenditure of which the revenue accounts for less than ¼ of GDP. ▪ Social expenditure is under-funded. ▪ Management of state properties, collection of non-tax revenues, and awarding concession contracts are not transparent. ▪ Salaries are among the lowest in the world, hindering effective and efficient public service thereby causing poor morale and corruption.

Source: Selected from matrix A2.7 in Appendix 2.

However, the government has officially launched its “Public Financial Management Program: Strengthening Governance Through

⁴⁷ Remarks by Robert P. Hagemann (IMF), On Behalf of Development Partners 2004 Consultative Group Meeting, December 6, 2004.

Enhanced Public Financial Management,”⁴⁸ initiative, just before the CG7 meeting, to again present its commitment to reforms. The program lays out a long-term vision (until 2015) to achieve a “comprehensive and systematic public financial reform program”, being divided into four major stages. For the first stage (2004 to 2006), the “MEF will implement over 200 actions spanning 27 major important activities.”

But only when these promises turn into concrete results can the government secure its creditworthiness and reputation. This can only be achieved through the government’s effectiveness in increasing the national revenue to its potential level and especially in reaching the same level of other developing countries with budget revenue accounting for 15 – 20 percent of GDP.

7.2. Public Expenditure Reforms

Better revenue mobilization would provide room for improving public expenditures aiming at efficient and sufficient public service deliveries. Concurrently, a simple rule applies that all expenditures must be transparent and at lower costs. The government intended to increase budgetary disbursements to four priority action ministries to 3.6 percent of GDP by the end of 2002⁴⁹, through a scheduled reduction of spending on defence and security, and a projected improved performance in revenue collection.

Along with the above-mentioned strategies and the action plan of the government to improve the livelihood of people through increased spending on social and priority sectors, some measures have been taken on public administrative and military reforms. Military demobilisation and a civil servant census were conducted to reduce the burden of huge expenditure on defence and security, and the redundancy of civil servants. Some other steps were taken to speed up disbursement for social sectors that experience delays and low rates of actual spending.

The Medium Term Expenditure Framework 2003 – 2005 was introduced in 2002 along with the Priority Action Plan (PAP) to link public expenditure to long term development programs. The National Auditing Authority was established to oversee regularity, transparency and accountability of all public expenditure. Public procurement is currently applied to all ministries except the Royal Palace.

⁴⁸ It is also available at http://www.cdc-crdp.gov.kh/cdc/7cg_meeting/download/pfm_reform_program_eng.zip.

⁴⁹ *Idem with 13.*

According to the EIC's estimates, defence and security spending declined from 3.8 percent of GDP in 1999 to 2.4 percent of GDP in 2003, and was expected to decline to 2.3 percent in 2004. Priority sector expenditure has been steadily increasing from only 1.5 percent of GDP in 1998 to around 3.3 percent of GDP in 2002 and 3.2 percent in 2003. And it is unlikely that the government can meet the target of 3.8 percent of GDP in 2004 given the currently slow and low disbursement to these priority sectors.

Again, this benchmark was "not met", according to donor evaluation at the CG meeting in December 2004. Noticeably, while the government has failed to increase social expenditure at the intended level, the management of overall expenditure is very poor, costing millions of US dollars through corruption and other illicit spending (cost-inflating, invoicing without actual spending, etc.).

With support from donors on the aforementioned long-term reform program, the government should seize this opportunity to really address the remaining issues at this stage. The successful implementation of the program will benefit the whole nation through better allocation of resources for national development and poverty reduction. The government has laid out the above-mentioned long-term action plan aiming at (i) a more credible budget; (ii) effective financial accountability; (iii) the RGC's policy agenda becoming fully affordable and prioritized; and (iv) RGC managers becoming fully accountable for program performance.

The problem of overspending, for its part, can be solved in the short-run via commitments to lowering costs of administration, such as opening bidding of all supplies to the government, cutting unnecessary spending, and further strengthening of internal and external auditing.