

**PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: AB3001

Operation Name	First Development Policy Grant
Region	EAST ASIA AND PACIFIC
Sector	Other domestic and international trade (33%);General public administration sector (33%);General agriculture, fishing and forestry sector (12%);General education sector (11%);Health (11%)
Project ID	P071103
Borrower(s)	KINGDOM OF CAMBODIA
Implementing Agency	
	Kingdom of Cambodia Cambodia
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1. Country and Sector Background

Cambodia is a post-conflict country, and though the Paris Peace Accords formally established a truce in 1991, politico-military violence continued until 1997. Many important institutions of governance and public sector management, destroyed during the Khmer Rouge period, are only just starting to be rebuilt according to democratic and meritocratic norms. The conflict has contributed to weak governance and high levels of corruption. Poor governance is thus the primary constraint on development in general and on the World Bank Group's program in particular.

Cambodia's devastating conflict—many important institutions of governance were destroyed during the Khmer Rouge period and are only just starting to be rebuilt—has resulted in weak governance and high levels of corruption. The Transparency International (TI) Corruption Perceptions Index (CPI) shows that the level of corruption in Cambodia is perceived to be high, though comparable to those of other Low Income Countries under Stress (LICUS).

Cambodia's real GDP grew by 9.5 percent in 2006, following an unprecedented 13.4 percent growth rate in 2005.¹ In both years the stellar performance was driven by solid garment exports, strong tourism receipts, significant growth in FDI, the continuing construction boom, and robust crop growth in agriculture. Agriculture remained a crucial sector for the economy, accounting for 38 percent of GDP growth and some 60 percent of total employment in 2005. Consumer price inflation is projected have fallen to around 3 percent in 2006, down from 6.7 percent in 2005.

A sound macroeconomic framework has helped underpin success in recent years, with Cambodia's GDP growth averaging 8.2 percent over the period 1994-2005. However,

¹ All figures for 2006 are projected.

Cambodia's narrow growth base remains a concern. Recent and ongoing work—including the National Export Strategy, 2007–2010, the Small and Medium Enterprise Development Framework, 2005–2010, and the second phase of the Integrated Framework (IF) for trade—aim to tackle this challenge. The microfinance institution loan portfolio grew by about 40 percent to US\$ 56.3 million in 2005 as compared with 2004, and credit to the private sector expanded by 29 percent in 2005 and is projected to have risen a further 35 percent in 2006. An improved legal and regulatory framework for investment in 2005 has likely contributed to greater FDI. Estimated FDI inflows rose from US\$ 121 million in 2004 to US\$ 381 million in 2005, and are projected to have remained robust at US\$ 394 in 2006.

Economic growth over the last decade has raised living standards and reduced poverty headcounts. Analysis of trends in consumption and poverty in Cambodia is made complex by the limitations of the data. However, when comparing living standards within the same geographical frame in 2004 and 1993/4, average per capita household consumption is found to have risen 32% in real terms (to 2,932 riels per day in 2004). In Phnom Penh and other urban centers the rise has been considerably more dramatic.

2. Operation Objectives

PRSO-1, the first in a series of three annual operations, would selectively focus on the key reform areas of private sector development (PSD), public financial management (PFM), and land and natural resources management (LNRM). Of these areas public financial management and private sector development are the most advanced in terms of agreement on reform measures. These areas would provide the prior actions for PRSO-1 and the triggers for PRSO-2 and PRSO-3. To help reduce the burden of multiple conditionalities, all of these prior actions are derived from either actions agreed at the 2006 CG meeting, or from sectoral strategy commitments agreed by the relevant technical working groups.

The operation's development objective is to support 'second generation' growth and poverty reduction based on an improving business climate, higher agricultural productivity, and more effective public service delivery. The PRSO will support the next phase of policy and institutional reform required to maintain growth and accelerate poverty reduction by facilitating trade and diversifying exports, guaranteeing land tenure and increasing access to land for the rural poor, and making the budget a credible management tool and reducing fiduciary risk to public funds. The PRSO program would support outcomes that are driven by policy measures and expenditure policy, both of which are supported by the development partner community as necessary for underpinning medium term growth and accelerating poverty reduction. PRSO-1 features 12 prior actions across private sector development, public financial management, and land resources management.

3. Rationale for Bank Involvement

The principal purpose of the proposed Poverty Reduction Support Operation (PRSO) program (2007-2009) is to provide support for the implementation of the "good governance" reform program laid out in the Royal Government of Cambodia's (RGC) National Strategic Development Plan (NSDP), 2006-2010. The NSDP is intended to operationalize the "Rectangular Strategy for Growth, Equity and Efficiency," which was adopted by the new

Government in July 2004. The Rectangular Strategy placed “Good Governance” squarely at the heart of the reform agenda. The Country Assistance Strategy for Cambodia, endorsed by the Board in May 2005, follows the Rectangular Strategy by recognizing governance issues as the primary obstacle to growth, poverty reduction, and aid effectiveness in Cambodia. The Bank is uniquely placed to lead on moving to budget support given its role in the development partner community.

4. Financing

The Bank will provide between USD 15 and 20 million for the operation. Several other potential co-financiers are also very interested in supporting PRSO-1.

5. Institutional and Implementation Arrangements

The beneficiary is the Royal Government of Cambodia (RGC). PRSO-1 is a single tranche grant that will be disbursed upon effectiveness after the opening of a dedicated foreign currency reserve account at the National Bank of Cambodia. It is envisaged that there will be two further single-tranche PRSOs on a twelve to eighteen month basis, depending on the speed of the reform program.

The RGC will be responsible for the overall implementation of the PRSO program. MEF coordinates with other ministries through the multi-ministerial Committee for Economic and Financial Policies (CEFP), and through bilateral meetings. MEF also prepares a regular report on PRSO progress. Bank supervision will focus on regular verification processes that monitor implementation of the policies being supported by the PRSO and the PFMRP. The Bank’s monitoring will be aligned with the government’s monitoring and evaluation of the NSDP, which will occur through the TWGs. The PSD, PFM, and Land TWGs are chaired by the Bank on behalf of the partner community, which allows for close supervision of PRSO actions and triggers.

6. Benefits and Risks

The PRSO program (2007-2009) has three expected benefits: (1) higher rates of growth and poverty reduction based on an improving investment climate, higher agricultural productivity, and more effective public service delivery; (2) a reform dialogue with Government more focused on results; and, (3) improved harmonization and alignment of development partner policy positions and financial support.

While there is strong ownership of the reform program at the MEF, there appears to be less commitment in some of the other agencies. Elections in 2008 raise the risk of a reform slowdown. Implementation of the reform program could also be delayed because of weak capacity of public institutions, especially at the sub-national level, which could impede the implementation of proposed reforms. Corruption in Cambodia, also a critical constraint, has exerted a negative impact on the implementation of the reform program. In a weak governance environment there is also a reputational risk of providing budget support.

7. Poverty and Social Impacts and Environment Aspects

Trade facilitation and investment climate improvements are likely to spur growth primarily in Cambodia's urban areas. The actions supported under the PRSO program will likely lead to increased private investment and higher and more diversified exports. As investment and exports expand, formal sector jobs will increase, especially in the traded sectors (e.g., through trade facilitation the reduction in informal fees would be passed on to labor in greater employment and higher wages). These reforms are needed to push Cambodia's medium term growth above the projected 6 percent level.

The PFM reform program is intended to mobilize higher resource levels and improve the management of public resources, both of which should result in a higher quantity and quality of pro-growth, pro-poor service delivery. Greater revenue will allow higher levels of expenditure in both the neglected economic sectors—transportation, agriculture, irrigation, and energy—as well as in the social sectors, which have benefited from significant increases in funding over the past years (Table 6). Improvements in PFM systems will also allow for more efficient and effective spending, generating higher rates of return on investment projects and greater impact in terms of the efficiency of service delivery.

The PRSO program would support growth in rural areas through more secure property rights, provision of social land concessions to small-holders, and crop diversification. Agriculture remains central to the livelihoods of the great majority of Cambodians, and particularly poor Cambodians. In 2004, 91% of the poor lived in rural areas; 63% of poor households (and 51% of all households) reported agriculture as the occupation of the head of household. In the interests of poverty reduction it is thus critical that land, as the key productive asset in agricultural production, is managed equitably. Improved land resource management can be expected to exercise a strong positive influence on growth and the reduction of poverty via: (1) enhanced agricultural productivity arising from increased security of land tenure; (2) increased attention to public interest and developmental goals (equity, rural livelihoods, state revenue generation and environmental sustainability) in the management of state land assets; and (3) direct improvements in the welfare of poor households which are the beneficiary of equitable and efficiently-managed land distribution.

The Task Team's assessment is that the operation is not likely to have any significant environmental impacts, but that the operation would be supported by a Strategic Environmental Assessment in FY08.

8. Contact point

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