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CENTER FOR INSTITUTIONAL REFORM AND THE INFORMAL SECTOR
UNIVERSITY OF MARYLAND

EXECUTIVE SUMMARY

OF

REPORT TO USAID/CAMBODIA

ON THE INITIAL ASSESSMENT OF INSTITUTIONAL REFORM ISSUES

AFFECTING THE ENABLING ENVIRONMENT FOR ECONOMIC

GROWTH

1. Introduction

IRIS¹ was asked to perform a review of major institutional or "enabling environment" issues affecting economic development in Cambodia, and of the programs under USAID's Democracy and Governance Program that attempt to address those issues. On this basis, IRIS would present to AID an analysis and recommendations concerning issues of highest priority where AID might play a future role in supporting institutional reform and economic progress in Cambodia.

IRIS's task was designed as a two-team effort. The first, three-person, team spent ten days in Cambodia, conducting interviews with some 30 to 35 representatives of donor governments, international donor agencies, NGOs, and the Royal Government of Cambodia (RGC). This report should serve as a guideline and starting point for the second team.

2. The IRIS Perspective

The work that IRIS has been doing on Cambodia and other developing countries employs a distinctive perspective to problems of economic development. The main characteristics of the IRIS perspective can be summarized as follows:

¹ Center for Institutional Reform and the Informal Sector (IRIS) University Research Corporation International, University of Maryland.

- IRIS presumes that USAID's resources for Cambodia are severely limited. Hence, direct aid in the form of, say, capital goods would be very small in relation to Cambodia's needs and, hence, probably not very effective.
- A common factor in countries which experience rapid economic growth is that their institutional environments have ensured that firms and individuals engage in mutually advantageous trade. Foreign aid may contribute to the establishment of such an institutional environment through education, technical assistance and policy-targeted research.
- Favorable institutional environments do not, however, mean complete absence of governmental activity. Specifically the government and its courts have the function of enforcing contracts.
- Thus, instead of using USAID funds to augment directly Cambodia's resource base, IRIS proposes that it should, in close conjunction with the USAID/Cambodia examine the ways in which well targeted and well designed intellectual inputs can contribute to the process of institutional evolution and policy design in Cambodia.

3. Priority Topics

The first IRIS team has identified tentatively five areas as priorities for AID/Cambodia's future assistance program strategy. They are highly interconnected. In particular the importance of building institutions in Cambodia cuts across all five themes as well as others. These institution building efforts would include working to improve urban rural linkages while emphasizing pilot projects which build on local institutional development initiatives.

IRIS suggests that USAID/Cambodia consider setting up a public policy institute with a long-term, interdisciplinary staff. The institute would have several functions: To monitor the economy, to assist in the implementation of institutional change, to establish and maintain close relationships with Cambodian policy makers by means of seminars and conferences, to arrange for short-term visits by experts on various specific topics, to collaborate and coordinate with other international donors and so on.

The following have been identified tentatively as the areas in which the need appears to be greatest:

- **Human Resource Requirements:** The institutional and resource constraints to rapid development of skilled personnel need to be addressed on an urgent basis. This would include configuring, or re-configuring, training programs, licensing requirements, and human

resource-related laws and regulations (e.g. immigration law) to maximize incentives and remove obstacles for those wishing to improve their skill levels through education and training programs.

Additional AID support should be considered for technical assistance aimed at achieving incentives -- that is, training program structures, professional licensing rules, and relevant laws, etc. -- that are rational in light of Cambodia's human resource needs. In view of limited resources, increased direct support for training programs is likely to be limited and highly focused.

- **State Building: Public Law and Transparency:** The development, passage, and implementation of enabling legislation related to the powers of, and relationships among, branches of the Royal Government of Cambodia is urgently needed. In any system, this is the necessary predicate for transparent, rule-bound behavior by executive agencies, courts, and legislative bodies. This, in turn, is fundamentally important to investors, as it determines the level of confidence they can have that government will treat contracts, property rights, and economic regulation according to known and stable rules. Cambodia suffers from serious lacunae in this area.

Suitable activities for USAID assistance may be: Technical and related support for the development of a basic infrastructure of public law, including organic legislation on the functioning of the executive and the courts, and administrative law. It is also important to consider implementation mechanisms such as the creation of an international transparency committee, a government agency willing to act as a laboratory for transparent rule making and execution and a research and training institute capable of disseminating these ideas to officials from all branches of government as well as the general public.

- **Land Tenure:** Achieving a system of clear and respected real property rights is widely acknowledged to be of surpassing economic importance to Cambodia. An effective land tenure system, including mechanisms for registration and adjudication which are trusted and used, can spur agricultural production, stimulate capital markets, and help ensure sustained investment growth. Such a system is absent in Cambodia, and what functioning land markets there are, operate only on the principals' confidence that powerful government figures stand behind any title document.

USAID could support the following technical assistance: seminars and similar activities on the formulation of options for reform of land tenure, titling, and/or adjudication.

This could develop into a collaboration on the framing and implementation of a reform program and increasing the effectiveness of claims settlement procedures.

- **Private Sector Development:** Cambodia is at a very early point in the development of a private sector. Apart from new starts, Cambodian enterprises went into private hands only within the last few years, and public sector attitudes at all levels still have a strong dirigiste flavor. As a result, the need for support to develop entrepreneurs and new businesses is vast, and includes training, advisory services, business incubators, credit programs, and other basic forms of aid.

USAID should consider supporting a program of assistance to small and medium sized businesses and other private sector developments, possibly including training, incubators, advice on basic regulatory and business licensing reform, etc.

- **International Trade and Investment:** Cambodia needs to develop commercial linkages as rapidly as possible. In order to do so, it must provide potential trade and investment partners with the maximum incentives to enter business relationships that will be of benefit to Cambodia. This requires both a well-considered trade and investment policy and accession to the relevant international conventions, including the World Trade Organization, the Association of South East Asian Nations, and other bilateral and multilateral arrangements. Professional handling of these issues is probably beyond Cambodia's present human resource capacity.

A suitable activity for USAID may be: Technical assistance in the formulation and implementation of international trade and investment policies with emphasis on accession to relevant international conventions.

Proposed Scope of Work
IRIS Buy-in (ANE-0015-B-00-1019-00)
Step One Follow-On
USAID/Cambodia
October 13, 1995

1. Introduction

IRIS has been tasked with assisting the USAID Cambodia Mission to develop new priorities, strategies, and programs that will address critical needs and gaps in the enabling institutional environment for economic development in Cambodia. In its report to USAID/Cambodia at the conclusion of its initial visit, IRIS proposed five areas as priorities for AID/Cambodia's future assistance program strategy. They are: Human resource requirements, public law infrastructure, land tenure, private sector development, and international trade and investment. IRIS also identified some cross-cutting issues of institution-building and program implementation, especially the need to strengthen and institutionalize Cambodian capacity for policy-related research and analysis. This listing of issues is intended not to be exhaustive but to focus strategic thinking on those areas that are both most critical to the institutional environment for growth and are not the object of major assistance efforts by any donor agencies. The findings of the first team also provide starting points for further investigation by the IRIS team in the second stage of its assignment.¹

For this follow-on stage, AID has requested that IRIS

continue the dialogue and assist the Mission in further refining the strategic approach, elaborating on opportunities for USAID/Cambodia to provide value-added, technical assistance

and

prepare a written report outlining the recommended focus of USAID legal and institutional framework activities, taking into consideration the critical elements needed for the establishment and functions of a strong free market economy and progress in continuing the consultative process.²

This follow-on assessment will involve a visit by an expanded (five-person) IRIS team, which will conduct more in-depth research and discussions on the above topics and submit a final report to AID. The additions to the team will be an Institutional Economist/Team Leader and a Southeast Asia Rural Development Specialist. The team will visit for approximately three weeks and write a report suggesting the most effective strategies and programs for AID to address the core issues mentioned above -- given its current overall strategy and the programs now operating with AID and other funding.

¹See IRIS draft report dated October 9, 1995 for further details.

²USAID PIO/T 442-0110-3 pp. 4 and 5.

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2. Priority Issues For Further Investigation

Following is a discussion of the major substantive questions and possible AID interventions that the second IRIS team will pursue. The issues are presented comprehensively in order to guide the team's investigation and analysis. It is not suggested that the team will definitively answer all questions, since time and information are limited. Rather, the team will follow the lines of inquiry presented below, to the extent feasible and necessary to assist AID in the definition of its strategy and programs.

In each area, the team will try to address the following questions: What are the most critical priorities for reform in a given area? Where are the pressure points, and who are the supporters of reform? Why has there been no effective response by the Cambodians -- i.e., what are the needs and constraints? Will an intervention by AID (apart from programs and activities already in existence) make an appreciable difference to the existence and sustainability of reform, what form should it take, and what level of resources would be required? Are parallel or cooperating efforts needed by other programs, donors, or governments to achieve the desired objectives? What Cambodian entities could be tapped as potential partners of an AID program?

Human Resource Requirements

It is abundantly clear that Cambodia's need for skilled personnel is severe, and that its current resources fall far short of what would be required to train sufficient personnel in a compressed time frame. Donor agencies have stepped in with support for training and professional education programs. At the same time, institutional constraints such as educational and licensing requirements, immigration rules, and capital market imperfections appear to inhibit the expected market response of rapid human resource development and deployment.

The questions IRIS poses here are: What exactly are those institutional constraints? What are their impacts? What are the most important and effective policy responses needed in this area, and how can AID support such responses?

The following is an illustrative menu of the types policy issues the second IRIS team will pursue:

The effect of imperfect capital markets on access to education and training

The shortage of part-time or continuing education and training facilities

Private sector provision of training

Corruption in higher education

Formal educational requirements for professional licenses

Restrictions on immigration and employment of non-Cambodian nationals

Extremely low pay levels for civil servants.

IRIS will also look into the possible impact and feasibility of AID support in this area. Potential programs to be investigated include:

Removal of Constraints: AID technical assistance in revision of laws and regulations creating obstacles to rapid human resource development, and in policy development to provide future incentives in this area.

Inducements to Training and Education:

- Assistance in setting up an institution to provide training and degree-equivalency certification.
- Support for a system of accreditation of educational and training institutions.
- Support for institutions which encourage education or training by employers.
- Assistance in development of incentives, recruitment, and exchange programs to bring in additional skilled expatriate Khmer.
- Assistance in development of supportive financial markets and financing methods for education and training, e.g. vouchers, scholarships, loans

Direct Provision of Education and Training: support for professional training, short courses, study-tours.

Work in this area will entail further research, including comparative study of incentives and institutional supports for training in other countries facing similar problems, observation visits to education and training centers, and meetings and discussions with educators, students and trainees, employers, officials, donor agencies, and others. These investigations are expected to yield more specific data on training and manpower needs as well as potential policy interventions.

State-Building: Public Law and Structures of Accountability

A number of central features of the RGC's operations perpetuate a lack of transparency, minimal public input, and rampant accusations of corruption -- not all of which are without basis. The crux of this problem appears to be the lack of a working public law structure of accountability, including administrative law, and organic legislation defining the roles of executive bodies and implementing the court system outlined in the Constitution. Without these structures in place, there are few restraints to executive prerogative, personality-based power relations, and corruption. This, in turn, makes the predictability and credibility of policy commitments, which are key to investment decisions, impossible.

In this follow-on assessment, IRIS will investigate such issues as the following. Which are the most critical pieces missing from this system? What efforts are underway to address this? Who are the leading advocates of reform within the government and outside, and are they potential partners of an AID program in this area? Where does the greatest concentration of knowledge

and capability in this area reside, and how might this be further developed and supported? What might an AID program look like in this area, and how can it be packaged and negotiated with the Cambodians in a way that can overcome or avoid political sensitivities?

IRIS will investigate the possibility of AID support for the enactment of a regime of enabling legislation creating an independent judiciary and transparent rule-making in the Executive. This could take place in the context of direct assistance to the framers as well as a broad based effort to directly disseminate information about these issues.

IRIS will research the coverage, quality, and gaps in the following areas of public law, and evaluate the need for, and possible impact of AID assistance in developing these laws:

Law Establishing The Organization, Powers And Functions of The Constitutional Council.

Administrative Procedure Act

Law On Government -- defining the organization, jurisdiction and authority of executive agencies.

Judicial Powers Act -- defining the basis for judicial independence by defining the organization and structure of the judiciary.

Law On Legal (Statutory and Constitutional) Interpretation

Other laws: Law on Judicial Procedure and Ethics, Judicial Marshals Act, Code of Government Ethics and Financial Disclosure, Government Procurement Code.

The following project components will be considered:

Expert drafting assistance to the Government of Cambodia in the areas listed above.

Workshops to provide government officials and NGO community with wider understanding of the legal and political foundations of accountable rule-making, judicial independence and implementation of the law by the executive and the judiciary.

Support to create institutional capacity to provide ongoing policy advice to government officials, teaching and research for the wider legal and political community and dissemination capacity for general population on issues of executive accountability and legal implementation. This institution could take the form of a think tank that provides objective information about political, legal, economic and social policy.

Support for an international transparency oversight mechanism. This might take the form of a coalition of international donors who have an interest in ensuring that the laws of Cambodia are enforced form a Transparency Monitoring Committee.

Support for a ministerial transparency laboratory.

Training of government officials and legal professionals in public law issues of executive accountability, judicial independence, and legal implementation. Improvements in officials' knowledge in these areas could result from formal training and education and/or collaborative work on drafting and implementation of new public law structures.

This assessment will involve extensive interviews with government officials throughout the bureaucracy to determine the existence of internal regulations about the organization and structure of bureaucratic rule making. This assessment will also entail interviews with officials at the Ministry of Justice and the Supreme Council of the Magistracy concerning the organization and functioning of the judiciary. One of the goals of this assessment will be to identify government officials within the Executive branch who understand the significance of this enabling legislation and who would support its enactment. In addition, the assessment should also attempt to identify Cambodian support outside the government for this process. Attention will be paid not only to the enactment of the framework but the process by which it is accomplished. Therefore, the assessment should consider which existing institution might be used to disseminate ideas to educate officials and the interested public about this issue.

Land Tenure

The land tenure system in Cambodia is fraught with uncertainty, which results in lack of confidence in property rights, deterrence of many forms of investment, and restrictions on the flow of capital. Three main aspects of the problem emerge from the initial assessment. First, the applicable laws appear to have some inconsistency, which makes it difficult to draw clear lines and restrain powerful parties from abusing the system. Second, even if the laws were consistent, their implementation through the virtually non-existent land registry systems, the courts, and RGC policy towards land allocation to the military and foreign investors is non-transparent and heightens uncertainty. Finally, unrest and dissatisfaction over the treatment of pre-1979 land claims continue despite the disposition of these issues in the current laws.

IRIS will investigate these three areas in more depth during the follow-on assessment. This stage will involve interviews with central and local government officials, registry personnel, judges and court personnel, litigants, claimants, investors, rural village and family heads, members of the legislative assembly and political parties, the military, and others. The relevant legal and regulatory instruments will also be analyzed. The team will also draw lessons and comparisons from land tenure systems and reform efforts in other countries, particularly those in the region, where similar issues have been faced. This is an area where discussion forums such as roundtables might be used to bring up competing views on land tenure and to begin facilitating a dialogue on reform.

Some of the major issues to be pursued are:

The functioning of existing titling and adjudication mechanisms. Who uses them, and are the results deemed satisfactory? How do the interministerial committees set up to deal with land claims function? Do old claims find their way into the system, and how are they dealt with?

The functioning of existing mechanisms of land tenure recognition and adjudication, especially in rural areas. How do the systems of family law prevalent in Cambodia affect the possession and use of land? How would these existing systems of rules be incorporated into, or affected by a reform program?

The economic costs of the existing system and of reform. What are the economic burdens and incentives of the current system, and what responses do they elicit from different classes of landholders? What are the likely costs of implementing the various land reform alternatives?

The nature of possible reforms. Would improved titling and adjudication systems, and protection against arbitrary seizures, be sufficient? Or would some aspect of redistribution be necessary to resolve the claims of returnees and others who have lost property?

The political feasibility of reform. Is land tenure-related reform (of any kind) ripe for serious political discussion within the next year, or would raising it as an issue create too much division and uncertainty?

Comparisons. What models of reform in land tenure, adjudication, and registration from around the world might prove applicable in Cambodia, and be fruitfully discussed?

The possible phase-in of land tenure system reform. Could it, e.g., start with urban areas, then move into rural areas, perhaps dealing with different categories of lands (e.g., contested vs. uncontested, forested vs. unforested) in separate phases?

Possible AID interventions to be explored range from drafting assistance to policy seminars. The main thrust is likely to be in improving implementation of the existing laws, and strengthening the mechanisms of titling, adjudication, and settlement of claims. A potential vehicle for AID assistance would be an advisory team interacting with the Council of Ministers; the National Assembly; the interministerial committees; relevant line ministries such as the Ministries of Justice, Interior, and Agriculture; the courts; provincial and local authorities; and/or CDRI. Mechanisms of outreach to the private sector and to the NGOs, particularly those active in rural areas, will also be considered. This could include testing new rules and procedures in pilot provinces or localities, or even replicating successful existing efforts in this area.

Programmatic questions that will need to be addressed in relation to potential AID interventions include:

Who are the potential Cambodian interlocutors on this question? Are any of them likely to be effective champions of reform? What constituencies might reform have, and can these groups be worked with effectively, or combined?

What provinces or localities might be promising pilot areas for early implementation of a land tenure reform program?

Private Sector Encouragement

Apart from the other issues relating to the economic enabling environment considered here, there appears to be a large unmet need for policies and institutions that will stimulate the development of an indigenous private sector in Cambodia. The needs range from supportive policies and incentive structures to more direct support for small entrepreneurs. The IRIS team will pursue this issue further by gathering more data on entrepreneurial activity, RCG policy initiatives, and possible AID interventions. This will involve discussions, roundtables, and perhaps rapid surveys of entrepreneurs, bankers, policymakers, local officials, and others.

The team will gather additional information on business activity, policies, and obstacles to new business formation and growth in order to develop a clearer sense of priority needs in this area. Basic information needs to be collected, including:

Quantitative estimates of business activity, investment, privatization, new starts, growth sectors, etc. (none of this appears to be accessible in organized form)

Information on business practices, including contracting, financing, marketing, sales and production ventures, ownership patterns, dispute resolution, etc.

Requirements, costs, and patterns of interaction relating to business formation, licensing, regulation, and tax collection

Operation of agricultural and rural credit markets.

Possible AID responses to be investigated include:

Assistance in the development of basic economic law and regulation, relating to contracts, bankruptcy, secured transactions, etc.

Support for the development of policies aimed at encouraging new and small-scale businesses, such as preferential tax and tariff treatment.

Assistance with programs of privatization of state-owned enterprises.

Assistance in improving the markets for agricultural products by, for example, increasing the information flow on product and input prices (e.g. via radio).

Support for simplified licensing and registration for new business enterprises.

Direct advisory assistance to new, relatively small businesses, e.g.:

- "Incubators" which provide legal, accounting, business management, marketing, labor management, and similar services to start-up businesses in return for a below-market fee.

- Revolving credit funds.

International Trade and Investment

Cambodia will clearly need to develop external sources of investment and export markets in order to sustain economic progress. While some liberalization has taken place, it is unclear whether the RGC has the wherewithal to take the next steps required to develop coherent trade and investment policies and to integrate Cambodia into regional and international markets.

In this assessment, the IRIS team will pursue the following types of issues relating to trade and investment policy:

What is the current mechanism for framing trade and investment policy? What agencies of government are involved, and how do they interact?

Is the current package of investment incentives adequate, or do regional and international investors expect more, and if so, what?

What are the requirements for entering WTO, ASEAN, and other arrangements? Are these well understood by the relevant members of the Government of Cambodia, and what assistance might they need in meeting these requirements?

What research and analysis capability is available to policy makers in this area?

What kinds of discussions is Cambodia holding with its neighbors, and where does Cambodia's integration into the area's economy stand?

Several directions for AID assistance will be investigated:

Assistance to the Ministry of Commerce and others involved in the development and institutionalization of an overall trade and investment policy for Cambodia

Assistance in the mechanics of accession, and the legal and regulatory changes required for membership, in regional and international trade organizations

Support for integrated policy reform through an advisory center, think tank, or series of seminars that brings the main actors together and attempts to build consensus towards the key steps needed -- and then assists with the implementation of those steps.

This part of the assessment will require documentary research: interviews with officials, entrepreneurs, and foreign trade and investment partners; and comparisons to policies in similarly situated countries and other ASEAN members.

3. Cross-Cutting Institution-Building Issues

The IRIS team will take an integrated view of the priority problems, approaches to reform, and possible AID interventions. Reflecting this approach, the team will further investigate the cross-cutting issues identified during the first IRIS mission:

The need to strengthen and institutionalize Cambodian capacity for policy-related research and analysis

The need for forums for policy dialogue between government and the private sector

The need for improved and expanded urban-rural linkages

The need to seize opportunities for encouraging restoration of Cambodian institution-building capacity and "social capital."

These issues will be investigated in the context of the priority areas for reform listed above, and also independently. IRIS will pursue possible AID responses to these needs, including:

Support for a policy institute or think tank

Support for associations of businesses, lawyers, and others concerned about reform

Building regional pilot activities into project designs

Identification and cooperation with, or support for replication of, successful local institutions of dispute resolution, financial intermediation, transparency, etc.

To the extent it becomes clear that other priority issues lend themselves to integrated institutional solutions, the IRIS team will follow those lines of inquiry.

4. Implementation

The IRIS team will consist of:

Peter Murrell, Institutional Economist/Team Leader

Frank Brechling, Economist

David Fagelson, Political Scientist/Lawyer

Patrick Meagher, Comparative/Commercial Lawyer

_____, Southeast Asia Rural Development Specialist.

Team members will spend overlapping periods in Cambodia. The Team Leader will be in-country for two weeks, and the Rural Development Specialist may need as many as four weeks, due to logistic issues of getting around the countryside. The other team members will spend up to three weeks in Cambodia. The overall timetable for the fieldwork will be approximately October 30

to November 24. This effort, including preparation time and expenses, can be accommodated within the resources remaining in the current Cambodia mission buy-in to IRIS.

The methodology for this assessment will consist mainly of interviews and documentary research. Where desirable and feasible, the team will hold roundtable discussions with groups of people interested in and knowledgeable about a particular set of issues. This makes possible a fairly rapid gathering of information, and can support dialogue and consensus-building. Other "rapid reconnaissance" techniques, such as limited surveys, may be used where appropriate. In order to bring a multidisciplinary approach to bear on all the priority areas, and to ensure an effective and integrated effort, team members will collaborate on and share responsibility for fieldwork in particular areas.

Whereas the initial assessment visit was limited to Phnom Penh, on the second visit, team members will visit at least three provinces outside the capital. A possible itinerary would include Siem Reap, Kampot, and Kompong Cham. The itinerary will be finalized in discussions with AID and Embassy personnel.

The IRIS team will make its own logistical arrangements, including travel, accommodations, and translators. AID will provide suggestions and starting points for these arrangements, facilitate briefings with relevant Embassy personnel concerning political and security issues, and arrange appointments with senior officials.

The team will hold entry and exit meetings with AID, in addition to regular update briefings, as AID requires and the team's schedule allows. The team will also submit a draft report before departing Cambodia.