



# **CAMBODIA**

# **ECONOMIC WATCH**

**OCTOBER 2005**

**ECONOMIC INSTITUTE *of* CAMBODIA**

Research Director:	Sok Hach
Project Team Leader:	Oum Sothea
Authors:	Oum Sothea, Neak Samsen, Dourng Kakada, and Sieng Deline.
English Editor:	Jessica Frommer



# TABLE OF CONTENTS

List of Abbreviations and Acronyms	iii
List of Tables and Figures	v
Foreword	vii
Executive Summary	ix
<b>Part I: Recent Economic Developments and Outlook</b>	<b>1</b>
1. Economic Growth	5
1.1. Agriculture	7
1.2. Industry & Construction	9
1.3. Services	12
2. Trade, Investment and Productivity	15
2.1. External Trade and Capital Movement	15
2.2. Private Investment and Stocks of Capital	17
2.3. Productivity	20
3. Prices and Monetary Developments	23
3.1. Inflation	23
3.2. Exchange Rate	25
3.3. Money Supply	26
3.4. Interest Rates	27
4. Fiscal Development and External Debts	29
4.1. Budget Revenue	29
4.2. Budget Expenditure	31
4.3. Budget Financing	33
4.4. Foreign Aid and External Debts	34
5. Labor Force, Incomes, and Poverty	37
5.1. Labor Force and Under-employment	37
5.2. Income Distribution	37
5.3. Poverty	38

<b>Part II: Structural Reforms: Current Implementation and Prospects</b>	<b>41</b>
6. Banking and Financial Sector Reforms	45
6.1. Banking Sector	45
6.2. Rural Finance	48
6.3. Insurance Sector	49
7. Public Financial Management Reforms	51
7.1. Revenue Mobilization through Customs and Taxation Reforms	51
7.2. Public Expenditure Reforms	53
8. Trade Reforms	55
8.1. Economic Integration	55
8.2. Trade Facilitations	58
9. Public Administrative Reforms	61
9.1. Civil Administrative Reforms	61
9.2. Military Reforms	64
9.3. Decentralization and Deconcentration Reforms	65
10. Legal and Judicial Reforms to Improve Governance	69
10.1. Legal Reforms	69
10.2. Judicial Reforms and Law Enforcement	73
11. Land and Natural Resources Management Reforms	75
11.1. Land Management Reforms	75
11.2. Forestry Management Reforms	77
11.3. Fisheries Management Reforms	78
<b>Concluding Remarks</b>	<b>81</b>
<i>Bibliographic References</i>	83
Appendix I: Cambodia Competitiveness Report 2005-2006	87
Appendix II: Key Economic Indicators	95

## LIST OF ABBREVIATIONS AND ACRONYMS

ACLEDA	Association of Cambodian Local Economic Development Agencies
ANZ	Australia New Zealand Banking Group
ASEAN	Association of Southeast Asian Nations
Camcontrol	Cambodia Import Export Inspection and Fraud Repression Department
CAMELS	Capital Protection, Asset Quality, Management Competence, Earning Strength, Liquidity Risk Exposure
CAMINCO	Cambodian National Insurance Company
CAR	Council for Administrative Reform
CDC	Council for the Development of Cambodia
CED	Customs and Excise Department
CG	Consultative Group
CLJR	Council for Legal and Judicial Reform
COAs	Chart of Accounts
COM	Council of Ministers
CR	Cambodian Riel
CSF	Commune/Sangkat Fund
D&D	Decentralization and Deconcentration
EIC	Economic Institute of Cambodia
EPSCB	Economic and Public Service Capacity Building Project
EPZs	Export Processing Zones
EU	European Union
FA	Forest Authority
FDI	Foreign Direct Investment
FTB	Foreign Trade Bank of Cambodia
GDP	Gross Domestic Product
ILO	International Labour Organization
IMF	International Monetary Fund
IPsCC	Intellectual Property Rights Coordinating Committee
LAMC	Law on Administration and Management of Communes/Sangkats
MDG	Millennium Development Goals
MDP	Management Development Program
MEF	Ministry of Economy and Finance
MFA	Multi-Fiber Agreement
MFI	Microfinance Institutions
MIME	Ministry of Industry, Mines and Energy
MLMUPC	Ministry of Land Management, Urban Planning, and Construction
MOC	Ministry of Commerce
MOH	Ministry of Health

MOJ	Ministry of Justice
MOT	Ministry of Tourism
MOUs	Memorandum of Understandings
MPDF	Mekong Project Development Facility
MPTC	Ministry of Post and Telecommunication
MTEF	Medium Term Expenditure Framework
NA	National Assembly
NBC	National Bank of Cambodia
NES	National Export Strategy
NGOs	Non Governmental Organizations
NIS	National Institute of Statistics
OCM	Office of Council Ministers
OWS	One-Window Services
PAP	Priority Action Program
PDP	Professional Development Program
PMG	Priority Mission Group
RCAF	Royal Cambodian Armed Forces
RGC	Royal Government of Cambodia
RSM	Royal School of Magistracy
SCCA	State Secretariat of Civil Aviation
SCM	Supreme Council of Magistracy
SEZ	Special Economic Zone
SMEs	Small and Medium Enterprises
SNCAC	Supreme National Council for Anti-Corruption
SWAP	Sector Wide Approach
TA	Technical Assistance
TRIM	Trade-Related Investment Measures
TRIPS	Trade-Related Intellectual Property Rights
TWGs	Technical Working Groups
UNDP	United Nations Development Programs
US	The United States
VAT	Value Added Tax
WB	World Bank
WTO	World Trade Organization

## LIST OF TABLES

Table 1.1.	Economic Growth of Cambodia and its neighbors (% , 2000 prices)
Table 1.2.	Cambodia's Economic Growth (% , 2000 prices)
Table 1.3.	Production of Agriculture Sectors (% increase, 2000 prices)
Table 1.4.	Production of Industry Sectors (% increase, 2000 prices)
Table 1.5.	Cambodia's Garment Exports (% increase, year average)
Table 1.6.	Production of Service Sectors (% increase, year average, 2000 prices)
Table 1.7.	Foreign Tourist Arrivals in Cambodia (% increase, year average)
Table 2.1.	Cambodia's Balance of Payments (% GDP)
Table 2.2.	Private Investment Projects Approved 2000-2005
Table 2.3.	Productivity of Workers (% increase, US\$ 2000 price)
Table 3.1.	Cambodia's Monetary Survey (End of Period, Billion Riel)
Table 3.2.	Cambodia's Interest Rate (% per annum, end of period)
Table 4.1.	Cambodia's Government Revenue (Billion Riel)
Table 4.2.	Cambodia's Government Expenditure (Billion Riel)
Table 4.3.	Cambodia's Financing Budget (Billion Riel)
Table 6.1.	Commercial Bank Expansion
Table 6.2.	Recent Development in Banking Sector
Table 6.3.	Recent Development in Rural Finance Sector
Table 6.4.	Recent Development in Insurance Sector
Table 6.5.	Cambodia: Gross Premium Written By Line of Business, 2004
Table 8.1.	Status of Progress of Enacting Laws for WTO Conformity, as of May 2005
Table 8.2.	Twelve Point Plan: Government Commitments to Improve the Investment
Table 9.1.	Recent Development in Public Administrative Reform
Table 9.2.	Recent Development in Decentralization and Deconcentration
Table 10.1.	Legal and Judicial Reforms
Table 11.1.	Recent Development in Forestry Reform

## LIST OF FIGURES

Figure 2.1.	The Most Problematic Factors for Doing Business in Cambodia
Figure 3.1.	Cambodia's Consumer Price Index (December 2002=100)
Figure 3.2.	Cambodian Riel against US\$, Thai Baht, and Vietnamese Dong
Figure 5.1.	Mean Real Household Consumption Per Capita By Per Capita Consumption Quintile
Figure 5.2.	Percentage of People Living on Less than US\$ a Day in 2004



## FOREWORD

Only two years since its inception in late 2003, the Economic Institute of Cambodia (EIC) has gradually established itself as one of the major independent research institutes focusing on a wide range of contemporary issues facing Cambodia. EIC has been working closely with the country's legislative bodies, governmental institutions, NGOs, domestic and international leading research institutes, media, and development partners on various issues through research projects, policy dialogues, trainings, workshops, conferences, and publications.

Staffed by a research team of well-qualified, dynamic, and a young generation of Cambodian professionals committed to excellence, EIC continues to play an active early-warning role in providing alternative but unbiased views based on intensive researches to alert policymakers and other stakeholders about the critical issues and their feasible and better solutions for the benefit of the nation.

To add to the stock of knowledge and sources of debate on socioeconomic policies, EIC is pleased to publish the 3rd issue of its bi-annual "Cambodia Economic Watch". This issue focuses on the current economic performance and prospects by looking in depth into the trend of economic growth and the most recent progress of reforms, and highlighting urgent measures to be taken to address the remaining problems.

Among the main features which emerged from our analysis are the slowdown in economic growth and marginal trickle down effects on the income distribution and poverty reduction, albeit high economic growth in the past decade. The concerns raised will hopefully create a new momentum for the reform acceleration in order to realize sustainable development and prosperity. Two main areas which deserved particular attentions are reforms in the public administration and in the legal and judicial system, the most problematic areas that directly hinder investment and business to flourish, and especially effective and efficient public service deliveries for all.

We would like to acknowledge the generous and continuous support from the World Bank, the United States Agency for International Development (USAID), The Asia Foundation, and other donor partners without which we can not pursue our stated mission. Special thanks to Chea Hout and the World Bank team for their comments and reviews, to Seiha Neou, Vuthy Chan, and Chak Riya Tuy for their valuable assistance, to all the EIC staff for their enthusiasm, and to other institutions and individuals too numerous to list.

*Sok Hach, Director*

*Economic Institute of Cambodia*



## EXECUTIVE SUMMARY

High economic growth performance in Cambodia in the last decade alone is no longer pleasant news for either the government or stakeholders. The simple reason is there is no automatic mechanism to ensure simultaneous growth and poverty reduction. The growth is not concomitant with social improvement such as in poverty, health, and education.

The baseline is no longer the “year zero” from 1975 – 1979 during which the country was plunged into the darkest pages in its history, the disaster and genocide, such that survival was the only ultimate hope of every Cambodian. Expectations on prosperity and national pride on the international stage are now unsurprisingly high in which the majority of stakeholders believe that Cambodia deserves, given the rich, natural and cultural resources.

According to the Economic Institute of Cambodia (EIC) estimates based on available data for the first nine months of 2005 and prospects for each sector, evaluation of reform progress and global economic environments, annual growth rate for 2005 - 2006 is expected to be around 5.0 percent down from 7.7 percent of 2004 and lower than the government forecast.

The growth rate continues to be boosted by high tourist arrivals, and expansion in residential constructions and real estate. But the current drought, a lower growth in exports of the garment and textile industry and the continuous hike of the international price of oil are factors causing a lower rate of growth. EIC estimate that a 10 percent increase in retail prices of petroleum will reduce GDP growth between 0.5 to 1 percent.

Agricultural production in 2005 will be either flat or slightly increase due to another year of severe drought in many paddy producing areas. Therefore, growth in agriculture is expected to be at roughly 1.3 percent compared with 2.4 percent forecasted by the government. The annual growth rate of the sector for 2006 is expected to recover and increase by 3.8 percent. The forecasted growth is based on an expansion in livestock, more arable (cleared) lands for other crops and paddy, given their favorable increase in prices and commitment of the government to rehabilitate countryside irrigation systems in the following years.

Based on data for the first nine months of 2005, EIC estimates that the growth rate of industry and construction for 2005 is down to about 7 percent due to a lower increase in garment and textile exports to the US and a decrease in exports to the EU markets. Cambodian exports of garments and textile were retained, thanks largely to “safeguard” measures taken by the US and EU under WTO rules which allows them to restrain an influx of Chinese imports to their markets.

Construction, however, is expected to slow down to 6 percent growth in 2005 down from 13 percent in 2004. The lower rate of growth is a result from a slow down in public constructions since many big roads have almost been completed. Lower disbursement of capital expenditure of the government in the first half of the year 2005 and few constructions of hotels are also the reason, despite continuous strong growths in garment factories and private constructions especially flats and apartments.

In 2005, projected growth rate of the services is 6.5 percent, about 3 percent lower than the growth in 2004. The forecast assumes moderate growth in the agricultural and industrial outputs, imports, exports, and the projected foreign tourist arrivals all of which utilise services. Based on trends and seasonality, EIC estimates that the number of international tourist arrivals will increase by 28 percent in 2005 compared with 2004.

Exports are still dominated by garments and textile but with lower growth rates. Projected total exports of goods and services for 2005 are US\$2.5 billion, 7 percent higher than 2004, and the imports are expected to be 14 percent higher, reaching US\$3.6 billion in 2005. The higher value of imports is due to higher prices, especially of petroleum, which will cause a wider trade deficit gap to 20.5 percent of GDP in 2005. Moderate surpluses from other accounts, especially from the services, FDI, and foreign assistance, will not be sufficient to cover trade deficits so the overall balance of payment will deteriorate.

According to data from the Council for the Development of Cambodia, registered investment projects and fixed assets in the first six months of 2005 soared and exceeded the total figure of the whole of 2004. The figure excluded three mega projects whose registered fixed assets are over US\$3.5 billion. EIC estimated that actual private investment for 2005 will continue to be strong even though construction of new hotels will decline. The garment factories to be built in 2005 are expected to double the number established in 2004 as the safeguard measures taken by the US and EU continue to curb Chinese exports of garments from flooding their markets.

Inflation continues to accelerate in the first nine of 2005. The overall price increased 5 percent in September 2005 compared with that of September 2004. This high inflation was fuelled by an upward trend of food prices and transportation costs in which each increased by 9 and 10 percent respectively. On average, prices of rice rose by 18 percent, where those of meat, eggs and fish increased around 20 percent. The price of gasoline increased 25 percent and that of diesel was 29 percent higher than in June 2004. Average inflation for 2005 is expected to be at 5 to 6 percent and both food prices and transportation will increase by 7 percent and 11 percent respectively.

The exchange rate of the Riel against US\$ will be weakened by a sharp economic slowdown in the rural areas, where the national currency is mostly used. Surges in imports especially for construction materials and vehicles and higher prices of imported petroleum were factors causing stronger demand for foreign exchange, especially US\$. Moreover, repatriation of US\$ abroad and speculations are also behind the fluctuations of the Riel

against the US\$. The average exchange rate of the Riel against US\$ in 2005 will stay around 4,200 Riel per US\$ compared with 4,025 Riel in 2004 or 4 percent depreciation.

Budget revenue continues to increase and is likely to meet its target of 2005, which is based on the low forecast of economic growth of 2 – 3 percent. Tax revenue increased by 22 percent in the first eight months of 2005 compared with the same period in 2004 and reached 68 percent of the annual budget target. Surprisingly, all taxes (VAT and Import Duties) on petroleum were 23 percent lower than for the first eight months of 2004, while petroleum imports (except diesel) increased significantly compared with that of 2004. Non-tax revenue was also close to a half of the annual target.

For the first eight months of 2005, expenditure reached only 56 percent of the budget level. Most ministries' spending was below 68 percent of their allocated budget. Salary payments were about 57 percent of the budget and non-wage disbursement was just 50 percent of the annual earmark. A slow reporting process from line ministries may be a reason for the low figures. However, overall expenditure in 2005 is expected to reach the target given better revenue performance. Budget disbursement as a share of GDP for priority sectors may reach 3.1 percent and wages will slightly increase but will still be below the target.

In a nutshell, concentration of growth and marginal trickle down effects of economic growth on income distribution and poverty reduction in the past decade requires an acceleration of reforms across sectors. Repeatedly, surveys and studies by EIC suggest that anti-corruption and reforms in the legal and judicial systems, the backbone of the rule of law, are the most urgent areas needed to provide an enabling environment for economic growth, equitable income distribution, and poverty reduction in the country. Most stakeholders consulted encourage the government to take decisive action to deal with these two fundamental problems for Cambodia's departure from the status-quo.

Reforms across sectors seem to yield some progress though still below expectations. The reform of the banking and financial sector completed its phase one at the end of 2004 and took off the phase two in 2005. Some progress has been made, especially in laying out a regulatory and supervisory framework for the banking and financial sector. Despite these achievements, commercial banks still play limited roles in facilitating investment, in particular in providing loans. The insufficient lending to business is due to reasons such as (1) weak credit risk assessment capacity of those commercial banks; (2) unavailability and in some case unreliability of borrower information; (3) absence of financial contract enforceability.

In its efforts to transform the public financial system into a pro-poor fiscal policy, the government of Cambodia has produced a "Public Financial Management Program: Strengthening Governance Through Enhanced Public Financial Management" and claimed full ownership in designing and implementing the reform process. The implementation of reforms seems to yield some progress. Tax revenue, the main component of revenues, on

average, increased by more than 10 percent annually during 2001 – 2004. Non-tax revenue was also improved at the same period but is still low.

The government has long been committed to increase budgetary disbursements to four priority ministries to 3.6 percent of GDP by the end of 2002. In fact, priority sector expenditure has steadily increased from only 1.5 percent of GDP in 1998 to around 3.3 percent of GDP in 2002, but the ratio has kept declining since then, to 2.9 percent in 2004. Spending on other civil ministries increased significantly at the same period. However, slower progress in management of expenditures, especially on priorities, reveals some bottlenecks in streamlining payment and executions of the budget to ensure a predictable and timely disbursement of funds needed for improving public service deliveries.

Medium Term Expenditure Framework (MTEF) has been introduced since 2002 along with Priority Action Plan (PAP) to link public expenditure to a long term development program, but the intended performance-based budgeting has not been introduced. Lack of capacity and low morale of officials to undertake systematic reforms across ministries are also grave challenges. Moreover, weak enforcement of public procurement procedures, absence of stricter financial and performance auditing caused the wastage of public funds.

In the area of trade facilitation and investment climate, progress of implementation of a twelve point plan has been made. Five out of twelve action plans have been carried out. The rest of the plans, which are more difficult than the five, are expected to be completed by December 2005. Another recent effort in trade reforms is the preparation of the National Export Strategy (NES) intended to reap potential benefits from market access of world trading systems and regional cooperation.

Even though military reforms have not made any progress, there are some results in public administration reforms, especially in decentralization and deconcentration. Decentralization and Deconcentration (D&D) is a way to place the government close to people to better understand the needs, preferences and priorities of each specific location. The government has agreed that D&D contribute to transparency, local participation, cost reduction and quality of projects, and sustainability.

However, most responsibilities of the commune councils have not been delegated yet as most public services are still under the control of ministerial and provincial lines. The commune councils have limited funds which result in a low level implementation of services and investments. The fiscal decentralization seems unforeseeable in the near future. This is due to several reasons including double taxation, weak capacity at all levels and government unwillingness to delegate power.

Reforms in legal and judicial systems recorded a slow progress. Many laws, most of which are the long unmet commitment of the government since the Tokyo CG meeting in 2001 are still pending. These texts include four drafts of basic codes in the civil and criminal areas, anti-corruption draft law and three judiciary-related draft laws, pertaining to

the organization and functioning of the courts, the amendment of the Supreme Council of Magistracy, and the status of judges and prosecutors.

Nonetheless, much concern is expressed over the adoption of the anti-corruption law since it has been criticised as not yet compliant with international standards and international good practices and a number of terminologies used therein are subject to further reviews. During a launching workshop on “Cambodia’s Draft Law on Anti-Corruption and International Standards” organised in mid-August 2005, the focus was on the method of assets declaration and principally over the independence of the future anti-corruption body.

With an emergency campaign called “Iron Fist”, the government vows to re-arrest armed robbers who are not in prison as a result of bribery, and to arrest corrupt judges and prosecutors. The Ministry of Justice has just created a committee for investigating cases of convicts who are on the loose, judges and prosecutors. Recently in July 2005, the Supreme Council of Magistracy (SCM) imposed sanctions on a number of judges and prosecutors involved, some of whom were to be removed from duty. It should be particularly noted that the Secretariat of the SCM was recently removed by the government’s sub-decree dated May 05, 2005.

However, a large part of this improvement are occasional measures while the reform of core and supplementary legal instruments relating to the organisation and functioning of the judicial system is currently blocked by the tardiness of the legal reform. In reply to this tardiness, no specialized court has been established so far and the municipal and provincial courts are still overloaded with dispute resolutions in almost all areas. The Supreme Council of Magistrates has not been restructured and thereby key reforms to enhance the judiciary’s integrity have not been met

For natural resources management, reforms in land, forest, fishery management are still the most important areas and urgent issues to lay the foundation for poverty reduction and sustainable development. Poverty incidents are closely related to landlessness, inaccessibility of the poor to forest and fishery resources, and above all low productivity growth in the natural-based rural activities. Indeed, the government has declared reform programs and taken some measures to improve governance in these areas.

Many issues remain, such as the grants of large-scale economic land concessions without appropriate socioeconomic and environmental impact assessment. Inadequate information on inventory of state lands, land classification and demarcations are sources of land grabbing. The government should also take urgent and strict measures to curb land concentration and large-scale idle lands by imposing high tax and selectively re-introducing an upper ceiling on the size of private land ownerships.

The reforms in forest management still face an uphill struggle due to many remaining problems. Many large forest lands have been cleared and are under private possessions. Forest offenses are still at large. Under-funding and lack of coordination

among government institutions and low capacity to manage and enforce regulations are the main obstacles.

For fisheries, protection of fishing shelters (inundated forests) and demarcation of fishing areas are urgent issues which need to be tackled. Awareness should be raised on preservation and be part of the educational curriculum. Development of other sectors such as the construction of irrigation systems, use of chemical substances in agriculture and industry must take viability of fisheries into account.

Development will not change the distribution of innate ability, and therefore will not change the distribution of income. There are no other suggestions except furnishing the measures that have been already prescribed by the government in poverty reduction and the Rectangular Strategy. The most urgent actions, however, are the reforms in land management with particular emphasis on the landless, whereby the poor will directly benefit.

The success of reforms in public finance is crucial to prevent revenue leakages and wastages, whereas those in legal, judicial and public administration are to provide a viable environment for private sector development to lead to growth and job creations. More investments are needed for better physical and social infrastructure, and for better public service deliveries. These factors will help redistribute gains from economic growth and poverty reduction.



**Part  
I**

**RECENT ECONOMIC  
DEVELOPMENTS AND  
OUTLOOK**



The question of development linkage between economic growth and poverty reduction has become a focal point of policy debates in Cambodia. Whether the country can reap the benefits from regional integration and membership in the World Trade Organization (WTO) is still a great challenge. Some observers and analysts have started questioning the country's readiness to compete in a global arena after "the graced periods" expire<sup>1</sup>. These graced periods resulting from the integrations have given Cambodia a formidable opportunity to prepare itself before fully opening up to the world. Others have warned against slow progress in critical reforms that could jeopardise both the national and socioeconomic security of the country. Nonetheless, the hallmark of policy debates is what course Cambodia should take in realizing the significant link between growth and poverty alleviation.

Cambodia has scored poorly in terms of quality of economic growth compared to its neighboring countries, according to available data from the World Bank East Asia Update<sup>2</sup>. While average economic growth in Cambodia during 2000 – 2004 was about 6 percent per annum, the poverty rate was up from 39.4 in 2000 to 42.4 in 2004. During the same period, average economic growth in Thailand was about 5 percent per annum, 5.7 percent in Laos, and 7.2 percent in Vietnam, but the poverty rate reduced from 3.6 to 1.5 percent in Thailand, from 15.2 to 9.2 percent in Vietnam, and from 33.9 to 23.2 percent in Laos during the same period.

In order to parlay objective debates into the making of good policy for a broad-based development in Cambodia, this issue focuses on recent economic growth and its prospects by looking in depth at both major macroeconomic indicators and sectoral performances domestically and internationally. The emphases are also on the current hike in prices of staple commodities (food stuffs) and intermediate goods (petroleum) and their impacts on the economy. The attempt is made to provide a plausible correlation between sectoral performance and income distribution that could shed a basic understanding on the poverty pattern of the country. Some suggestions are made based on prospects and the critical situation facing the country.

---

<sup>1</sup> EIC's opinion survey on Cambodia's membership in WTO.

<sup>2</sup> The World Bank, East Asia Update, April 2005.



# Chapter 1

## Economic Growth

High economic growth performance in Cambodia in the last decade is no longer pleasant news for either the government or stakeholders. The shift is now on poverty reduction that is playing a pivotal role in shaping the policy process for development. The simple reason is that there is no automatic mechanism to ensure simultaneous growth and poverty reduction.

The baseline is also not anymore the “year zero” from 1975 – 1979 during which the country was plunged into the darkest pages of its history, the disaster and genocide, such that survival was the only ultimate hope of every Cambodian. Expectations towards prosperity and national pride on the international stage are now unsurprisingly high, which the majority of stakeholders believe that Cambodia deserves, given its rich, natural and cultural resources.

Figures on high growth rates of the economy in recent years have failed to gain applause from many government officials and stakeholders because the growth is not concomitant with social improvement such as in poverty, health, and education.

According to EIC documentation and studies, strong economic performance in the past decade has produced minimal impact on the improvement of the Cambodian people’s livelihoods. The recent revision of national account estimates by the National Institute of Statistics (NIS) places the Gross Domestic Product (GDP) growth rate at 7 percent in 2003 and 7.7 percent in 2004, driven mainly by unexpected growth in garment exports in spite of the MFA phase-out, a boom in construction, and a record number of 1 million foreign tourists, plus large inflows of foreign assistance.

Available data for the first nine months of 2005 and various surveys are used in EIC’s revised forecast for economic performance for the year 2005 and the following year. The forecasted scenarios are based on prospects for each sector, evaluation of reform progress and global economic environments. While economic growth projected by the World Bank for Thailand is 5.2 percent, for Laos 7 percent, and for Vietnam 7.5 percent growth in 2005, EIC projects that Cambodia’s economy will grow at around 5.0 percent in 2005 down from 7.7 percent in 2004 and lower than the government’s forecast.

**Table 1.1: Economic Growth of Cambodia, and its neighbors  
(%, 2000 prices)**

	2002	2003	2004	2005e	2006p
Cambodia	5.2%	7.0%	7.7%	5.0%	4.9%
Laos PDR	5.8%	5.3%	6.0%	7.0%	6.5%
Thailand	5.3%	6.9%	6.1%	5.2%	5.6%
Vietnam	7.1%	7.3%	7.7%	7.5%	7.5%

**Sources:** *NIS and EIC for Cambodia, The World Bank for Laos, Thailand, and Vietnam.*

The growth forecast for 2006 is about the same rate as that of 2005 even though growth in the agricultural sector is expected to rebound. These growth rates continue to be boosted by high tourist arrivals, expansion in residential construction and real estate, and the good performance of the garment industry due to temporary measures taken by the US and EU to restrict their garment imports from China.

There are five main factors leading to the lower growth rates. Lower growth of exports of the garment industry, drought, and the continuous hike of the international price of oil are three current factors causing a lower rate of growth in 2005. Petroleum products account for about 1/3 of the total imports of goods, the second largest after imports of raw materials for the garment and textile industry. Preliminary analysis by EIC on the relation between prices of petroleum and intermediate inputs reveals that a 10 percent increase in retail prices of petroleum will reduce GDP growth between 0.5 percent to 1 percent. The reduction in growth is a result of an increase in petroleum-induced costs of intermediate inputs and deliveries, where selling prices either rise less than costs or are constant.

The fourth factor is the speed of reforms in critical areas, also affecting indirectly the economy's growth prospect in the following year. For example, growth in the agricultural sector, excluding weather conditions, is subject to irrigation renovation, natural resources management reforms, whereas growth in industrial and service sectors is dependent on multi-faced reforms in trade and investment, in public finance, and in the legal and judicial systems. Some of these reforms are unlikely to be achieved in the short term, but are feasible should political will exist.

Last but not least, external factors such as the continuous increase in the price of petroleum, the security situation, and changes in international trade regimes, especially the implications of Vietnamese membership in the WTO are important. These external factors continue to affect inflows of foreign direct investment (FDI), growth in competing

export industries and service sectors in the short run. The country's garment industry is facing stiffer competition so that actions are required in order to maintain the sector's competitiveness in the quota-free world. In fact, the garment industry has shown its weary strength of growth as its exports start to slow down from their high and fast growing period over the past five years.

**Table 1.2: Cambodia's Economic Growth (% , 2000 prices)**

	2002	2003	2004	2005e	2006p
<b>Agriculture</b>	<b>-2.8%</b>	<b>12.0%</b>	<b>-2.1%</b>	<b>1.3%</b>	<b>3.8%</b>
Paddy	-7.8%	22.3%	-12.3%	-0.4%	5.6%
<b>Industry &amp; Construction</b>	<b>17.7%</b>	<b>12.3%</b>	<b>16.5%</b>	<b>6.9%</b>	<b>5.4%</b>
Garments	21.2%	16.9%	24.9%	8.5%	7.1%
<b>Services</b>	<b>4.4%</b>	<b>0.1%</b>	<b>9.2%</b>	<b>6.5%</b>	<b>5.7%</b>
Tourism	18.8%	-10.3%	23.6%	17.9%	14.0%
<b>Total GDP</b>	<b>5.2%</b>	<b>7.0%</b>	<b>7.7%</b>	<b>5.0%</b>	<b>4.9%</b>

**Sources:** NIS for 2002-2004, and EIC model projection for 2005-2006.

Repeatedly, surveys and studies by EIC suggest that anti-corruption and reforms in the legal and judicial systems, the backbone of the rule of law, are the most urgent areas needed to provide an environment for economic growth, equitable income distribution, and poverty reduction in the country. Most stakeholders consulted encourage the government to take decisive action to deal with these two fundamental problems for Cambodia's departure from the status-quo.

### 1.1. Agriculture

Agriculture is natural-resource-based and is mainly comprised of paddy, crops, livestock, forestry, and rubber. The sector is very important to the economy for its immediate affect on living conditions of the poor. However, development of the sector depends on geographical and natural conditions. Without irrigation systems, most arable lands are suitable for only one-off paddy rice production a year such that drought continues to threaten the livelihoods of farmers.

In 2004, the country suffered from a severe drought and a sudden reduction of fish stock which caused agricultural production to decline by 2.1 percent. Paddy production fell by more than 12 percent and fishery was 3 percent lower than its production in 2003. Growths in the forestry and rubber sectors keep declining possibly the result from the government's

moratorium on commercial loggings and processing since 1999, in combination with illegal deforestations. However, continuous growth in other crops and livestock from 2003 showed a new driving force for agricultural diversification.

Most recent field surveys by EIC<sup>3</sup> confirm the growing tendency of farmers to complement their unpredictable paddy cultivation with animal (cattle, pigs, and poultry) and other crops. Livestock happens to be a new source of growth and income for the poor. However, lack of capital and inaccessibility to credits are the main obstacle for poor farmers to invest in animal husbandry. Therefore, an initial solution should be direct support in grants (prohibition on sale) of farm animals to the poor.

**Table 1.3: Production of Agriculture Sectors (% increase, 2000 prices)**

	2002	2003	2004	2005e	2006p
Paddy	-7.8%	22.3%	-12.3%	-0.4%	5.6%
Other Crops	-0.9%	29.0%	6.1%	2.1%	6.4%
Livestock	-1.2%	5.1%	4.3%	3.7%	4.1%
Fishery	0.6%	1.7%	-3.3%	0.9%	0.9%
Rubber & Forestry	-7.6%	-5.3%	-1.5%	-0.2%	0.0%
<b>Total Agriculture</b>	<b>-2.8%</b>	<b>12.0%</b>	<b>-2.1%</b>	<b>1.3%</b>	<b>3.8%</b>

**Source:** NIS for 2002-2004, and EIC model projection for 2005-2006.

For 2005, the agricultural production will be either flat or slightly increase due to another year of severe drought in many paddy producing areas such as Battambang, Prey Veng, Svay Rieng, Kampong Speu, Takeo and Kandal provinces. Therefore, growth in agriculture is expected to be at roughly 1.3 percent compared with 2.4 percent forecasted by the government. The annual growth rate of the sector for 2006 is expected to recover and increase by 3.8 percent. The forecasted growth is caused by expansion in livestock, more arable (cleared) lands for other crops, and paddy, given their favorable increase in prices and the government's commitment to rehabilitate countryside irrigation systems in the following years.

Nevertheless, seasonality of agricultural production, unexpected fluctuations of prices, and uneven distribution of land are the main challenges for the farmers to prosper. For some parts of the country, cultivation of paddy rice is the only option. Diversification of agricultural

<sup>3</sup> One of which was the EIC's Cambodia Poverty Assessment: Regional Case Studies, sponsored by the World Bank (forthcoming). Most focus groups consulted by EIC agreed that raising cattle and pigs are their main supplement sources of incomes and saving.

production is possible for others depending on natural endowments and economic conditions (comparative advantages, marketability, price stability, and institutional arrangements to support the process).

The lack of appropriate investment in irrigation systems, high input costs such as petroleum and fertilisers and price manipulations by middlemen are among the main obstacles to agricultural expansion and high income earnings for farmers. The mode of agricultural production is no longer purely free inputs from nature. Marketing and technological supports are still limited. An adequate energy policy, especially intended lower prices of petroleum, is fundamental to lower costs of production boosting the sector's competitiveness.

Institutional arrangements such as “contract farming” should be widely introduced. Moreover, a liaison office<sup>4</sup> to bring farmers directly to buyers should be established. The office will be a workable mechanism to reduce price manipulations from middlemen and to ensure the predictability of supply and demand forces of the market through execution of future contracts with fixed prices and quantities, the very favorable form of contracts that could prevent risks resulting from fluctuations (suppression) of prices<sup>5</sup>.

However, the starting point for the poor landless is simply to give them land for cultivation for their survival and grants in animal stock for them to prosper, provided that re-sale of these lands and grants is not allowed for a certain period of time. Land reforms, natural resources management are the decisive factors in achieving the government's goal of poverty reduction through strong and stable growth in agriculture.

## **1.2. Industry & Construction**

Industry in Cambodia is driven mainly by the clothing, apparel, and footwear sector. This high concentration has posed a serious concern on overall economic sustainability. Attempts have been made by the government to safeguard this sector through the labour compliance project monitored by the International Labor Organization (ILO) in order to secure orders from US buyers. The government is also lobbying the US Congress to enact the Trade Act through which countries heavily affected by the Tsunami and some poor countries including Cambodia are granted duty-free exports to the US markets.

---

<sup>4</sup> For more sophisticated arrangement, “future market for agricultural commodities” should be established. This has been long and common practice of many countries in the region and the world.

<sup>5</sup> It should be noted that lower prices of staple foods may be beneficial for net food consumers and encourage activities (such as livestock) rather than single paddy rice culture as argued by International Monetary Fund. (2004). *Cambodia: 2004 Article IV Consultation – Staff Report*. p. 31 – 38.

In 2004, total industry and construction grew by more than 16 percent supported by growth in all sectors except the food, beverage and tobacco industries, which declined due to a fall in agricultural products, according to a revised estimate of the NIS. However, the garment industry got an unexpected boost in spite of the quota-phase-out at the end of 2004. The garment and textile industries rose exceptionally by 25 percent due to their strong export performances which account for more than 84 percent of the total exports.

**Table 1.4: Production of Industry Sectors (% increase, 2000 prices)**

	2002	2003	2004	2005e	2006p
Garments and Textiles	21.2%	16.9%	24.9%	8.5%	7.1%
Food, Beverage & Tobacco	-1.2%	5.6%	-2.1%	1.6%	2.0%
Other Manufacturing	7.8%	0.7%	3.1%	3.3%	3.2%
Electricity, Gas and Water	17.1%	15.7%	4.7%	9.5%	8.6%
Construction & Mining	27.0%	11.0%	13.0%	6.4%	3.0%
<b>Total Industry &amp; Construction</b>	<b>17.7%</b>	<b>12.3%</b>	<b>16.5%</b>	<b>6.9%</b>	<b>5.4%</b>

**Source:** NIS for 2002-2004, and EIC model projection for 2005-2006.

Their total quantity exports increased by 26 percent boosted by a 21 percent increase in exports to the US, 34 percent to the EU, and 71 percent to the rest of the world. However, fiercer competition caused a decrease in prices of garment exports to the US by more than 5 percent compared with prices in 2003. Construction and mining also increased by 13 percent fuelled by soaring residential construction, followed by a 5 percent growth in electricity, gas, and water, and 3 percent growth in other manufacturing.

Based on data for the first seven months of 2005, EIC estimates that the growth rate of industry and construction for 2005 is down to about 7 percent due to a lower increase in garment and textile exports to the US and a decrease in exports to the EU markets. Total exports of garments in the first seven months of 2005 increased by only 10 percent compared with 23 percent growth in the same period last year. Cambodian exports of garment and textile were retained, thanks largely to “safeguard” measures taken by the US and EU under WTO rules to restrain an influx of Chinese imports to their markets.

The price of exports in the US market will continue to go down before adjustments of the world market for garments and textiles are

completed and when prices become more stable. However, prices in the EU are less volatile in 2005 and the following years for the market is more open.

**Table 1.5: Cambodia's Garment Exports (% increase, year average)**

	2002	2003	2004	2005e	2006p
<b>Quantity</b>					
USA	15.8%	10.2%	20.6%	22.6%	8.5%
EU	11.0%	19.3%	34.2%	-17.0%	0.0%
Others	65.1%	146.8%	71.1%	14.0%	15.0%
<b>Total</b>	<b>15.3%</b>	<b>14.7%</b>	<b>25.7%</b>	<b>12.4%</b>	<b>7.3%</b>
<b>Prices</b>					
USA	-0.6%	6.7%	-5.5%	-2.2%	-0.1%
EU	3.9%	-4.2%	6.3%	0.0%	2.0%
Others	-4.9%	13.5%	-4.2%	15.0%	3.5%
<b>Total</b>	<b>0.4%</b>	<b>4.7%</b>	<b>-1.6%</b>	<b>-2.3%</b>	<b>0.4%</b>

*Source: Ministry of Commerce for 2002-2004, EIC estimates for 2005-2006, based on the expert opinions.*

The construction sector, however, is expected to slow down to 6 percent growth in 2005, down from 13 percent in 2004. The lower rate of growth is a result of a slow down in public constructions since many big roads have almost been completed. Lower disbursement of capital expenditure of the government in the first half of 2005 and few constructions of hotels are also the reason, despite continuous strong growths in garment factories and private constructions, especially flats and apartments.

According to a forecast for 2006, growth in industry and construction is down to about 3 percent due to continuous weaker growth in garment exports and completion of construction booms in flats and apartments. The forecast is based on the assessment of export performances of garments and textile to the US and the likelihood of Vietnamese membership in the WTO in 2006 or 2007. The Vietnamese accession to WTO may divert FDI away from Cambodia and lead to some factory moves, given cheaper costs of displacements and incentives from the US removal of quota restrictions on the garment and textile imports from Vietnam<sup>6</sup>.

<sup>6</sup> Based on expert opinions.

The situation will be reversed if the Trade Act is adopted, through which Cambodia could enjoy tariff-free access to the US markets, especially for garment and textile exports. The actual implementation of registered investment projects would also affect the growth prospects of the industry and the economy as a whole.

The prospects for diversification of industry are largely dependent on the government commitments towards reforms and the ability to improve the business environment of the country. Studies by the World Bank, EIC, and other institutions<sup>7</sup> identify many constraints in doing business in Cambodia. Among these are higher costs of doing business which are mainly caused by corruption, costs of transportations, and higher costs for utilities due to the higher price of petroleum. The question is whether comparative advantages gained from the country's accession to regional and world markets are enough to attract foreign investments in spite of these myriad transaction costs.

### **1.3. Services**

Services have become the biggest sector in the economy since 1999 according to both NIS and EIC estimates. The most significant shares of the service sector are the wholesale and retail trades followed by transports and communications, and the hotel and restaurant sectors. Of particular notice, the large proportions in trade service and transport and communications reflect high intermediate transaction costs in economic activities.

For 2004, the service sector, excluding public administration, increased by more than 10 percent. Of all the gains, hotels and restaurants grew by 24 percent thanks to a record one million tourist arrivals into the country<sup>8</sup>. Other private services such as rentals and real estate also increased more than 11 percent following booms in residential and apartment constructions. Finance and banking also expanded both in areas of coverage and amounts of financial services operations.

The number of foreign tourists was up by 41 percent in 2004 after a 12 percent fall in 2003. The gains were the result of the country's security improvement compared with the threats of terrorism and violence in other countries. More frequent flights from the countries in the region to Cambodia are also factors leading to these higher tourist turn-outs.

Higher imports and exports, improvement in national and rural roads, and growing mobile phone and internet businesses boosted the

---

<sup>7</sup> EIC, Cambodia Competitiveness Report 2005-2006

<sup>8</sup> Excluding spot visitors to Preah Vihea Temple.

transport and communication sectors. In effect, they also helped facilitate trade in 2004. These sectors attained about 6 percent growth each.

**Table 1.6: Production of Service Sectors**  
(% increase, year average, 2000 prices)

	2002	2003	2004	2005e	2006p
Transport & Communication	7.6%	2.3%	6.2%	4.1%	4.4%
Trade	0.6%	2.2%	6.3%	5.6%	4.6%
Hotel & Restaurants	18.8%	-10.3%	23.6%	17.9%	14.0%
Other Private Services	1.8%	2.2%	11.2%	4.8%	3.9%
<b>Total Private Services</b>	<b>4.7%</b>	<b>0.4%</b>	<b>10.3%</b>	<b>6.8%</b>	<b>5.8%</b>
Public Administration	-0.3%	-4.3%	-6.8%	1.3%	3.1%
<b>Total Services</b>	<b>4.4%</b>	<b>0.1%</b>	<b>9.2%</b>	<b>6.5%</b>	<b>5.7%</b>

Source: NIS for 2002

For 2005, the projected growth rate of services is 6.5 percent, about 3 percent lower than the growth in 2004. The forecast assumes moderate growth in the agricultural and industrial outputs, imports, exports, and the projected foreign tourist arrivals all of which utilise services.

**Table 1.7: Foreign Tourist Arrivals in Cambodia**  
(% increase, year average)

	2002	2003	2004	2005e	2006p
Through Phnom Penh	5.3%	-22.6%	17.4%	25.0%	15.0%
Through Siem Reap	42.4%	-1.4%	66.1%	50.0%	35.0%
By Land & Boat	34.0%	-7.2%	47.3%	30.0%	20.0%
<b>Total</b>	<b>21.3%</b>	<b>-12.5%</b>	<b>40.8%</b>	<b>34.7%</b>	<b>23.7%</b>
<b>Number (000's)</b>	<b>801</b>	<b>701</b>	<b>987</b>	<b>1,329</b>	<b>1,645</b>

Source: Ministry of Tourism for 2002-2004, EIC Estimates for 2005-2006, based on the professional opinions

Based on trends and seasonality, EIC estimates that the number of international tourist arrivals will increase by 35 percent in 2005 compared with 2004<sup>9</sup>. However, based on the trends, the average growth rate of the services during 2006 is expected to stabilise at 5.7 percent growth with

<sup>9</sup> According to the Pacific Asia Travel Association, Cambodia topped the list of tourist arrivals in the Asia Pacific region in the first 6 months in 2005. Number of foreign tourists increased more than 50 percent, higher than data from Ministry of Tourism which estimates the rise at 38 percent for the first 6 months of 2005 compared with that of 2004.

moderate gains from all subsectors of the services. Prospects for the sector may be overturned by increases in the price of petroleum and depreciation of the Riel and inflation pressures that make financial services more expensive due to a possible raise in the lending rates.

## Chapter 2

### Trade, Investment and Productivity

#### 2.1. External Trade and Capital Movement

Imports and exports of goods and services reveal how well Cambodian industries perform both at home and abroad. The main foreign currency earners are garments and textile, tourist-related services, foreign assistance and loans. Cambodia has to pay for the imports of raw materials for the garment industry, imports of oil and gas, and most other manufactured goods. Moreover, outflows of currencies reflect the repatriation of interest payment on foreign debts, returns on investment, and salaries of foreign workers, whereas inflows are remittances from Cambodians overseas, FDI, and other transfers.

Data compiled from the government, IMF and EIC revised estimates reveal that total exports of goods in 2004 made up 47.8 percent of nominal GDP while the imports were 64.5 percent, leading to a trade deficit at 16.7 percent of GDP. The biggest exports of garments and textile reached about US\$2 billion up from US\$1.6 billion in 2003. Imports of goods also increased at the same pace amounting to US\$3.1 billion in 2004, about US\$500 million higher than that of 2003. The main import components are US\$1.3 billion of garment and textile raw materials and finished products and more than US\$800 million estimated imports of petroleum (including smuggling), US\$200 million higher than the amount estimated by the NIS<sup>10</sup>.

Higher arrivals of foreign tourists in 2004 contributed to a surplus in the balance of services, in spite of deficits in the balance of transportation as most of the air-transport to Cambodia is carried out by foreign airlines. The income balance was in deficit reflecting larger income payments to foreigners for their profits, interests and compensation of employees. However, Cambodia enjoyed huge inflows of current transfers from foreign grants and some remittances. These surpluses compensated for the trade deficit so that the current account deficit was 7.5 percent of GDP in 2004. With access to foreign borrowings and an increase in FDI, the overall balance of payment improved and stabilized. The surplus also strengthened the country's foreign reserve.

---

<sup>10</sup> National Institute of Statistics. (2005). NATIONAL ACCOUNTS OF CAMBODIA 1993 – 2004. Bulletin No.9. Table 8a.

**Table 2.1: Cambodia's Balance of Payments (% GDP)**

	2002	2003	2004e	2005e	2006p
<i>Exports of Goods</i>	42.9%	47.0%	47.8%	47.2%	47.1%
<i>Imports of Goods</i>	56.7%	59.6%	64.5%	67.6%	65.0%
<b>Trade Balance</b>	<b>-13.8%</b>	<b>-12.6%</b>	<b>-16.7%</b>	<b>-20.5%</b>	<b>-17.9%</b>
Agriculture	2.4%	4.1%	1.8%	1.8%	2.0%
Textiles & Garments	10.3%	11.9%	13.3%	13.4%	13.4%
Oil & Gas	-11.3%	-12.7%	-16.8%	-19.6%	-17.9%
Other Goods	-15.3%	-15.9%	-15.1%	-16.0%	-15.5%
<b>Balance of Services</b>	<b>5.6%</b>	<b>3.0%</b>	<b>4.1%</b>	<b>5.1%</b>	<b>5.9%</b>
Transportation	-3.1%	-3.5%	-4.3%	-5.2%	-6.1%
Travel (Tourism)	10.2%	8.1%	10.3%	12.5%	14.3%
Others	-1.5%	-1.6%	-1.9%	-2.1%	-2.3%
<b>Balance of Incomes</b>	<b>-4.1%</b>	<b>-4.2%</b>	<b>-4.6%</b>	<b>-5.3%</b>	<b>-5.6%</b>
<b>Current Transfers (net)</b>	<b>11.0%</b>	<b>10.9%</b>	<b>9.7%</b>	<b>9.4%</b>	<b>9%</b>
Private Transfers <sup>1</sup>	4.8%	4.7%	4.3%	4.1%	3.8%
Government Transfers <sup>2</sup>	6.2%	6.2%	5.4%	5.3%	5.1%
<b>Current Accounts</b>	<b>-1.3%</b>	<b>-2.9%</b>	<b>-7.5%</b>	<b>-11.3%</b>	<b>-8.6%</b>
<b>Capital &amp; Financial Accounts</b>	<b>7.0%</b>	<b>7.4%</b>	<b>7.8%</b>	<b>7.8%</b>	<b>6.7%</b>
Official Loans <sup>3</sup>	3.8%	3.4%	2.8%	2.7%	2.5%
Foreign Direct Investment	2.0%	2.9%	4.0%	4.1%	3.4%
Others (net)	1.1%	1.1%	1.0%	0.9%	0.9%
<b>Change in Foreign Reserves<sup>4</sup></b>	<b>5.6%</b>	<b>4.5%</b>	<b>0.3%</b>	<b>-3.5%</b>	<b>-1.9%</b>
<i>At the National Bank</i>	2.8%	1.7%	0.9%	0.4%	0.3%
<i>Outside the National Bank</i>	2.8%	2.8%	-0.5%	-3.8%	-2.2%

**Source:** IMF-EIC Balance of Payments Statistics for 2002-2003, EIC model projection for 2004-2006.

<sup>1</sup> Money transferred by Cambodian overseas.

<sup>2</sup> Grants provided by donors to the government.

<sup>3</sup> Net of debt amortization.

<sup>4</sup> Overall balances reflect change in country's foreign reserves. As Cambodia is a dollarized economy, and private individuals and institutions can hold foreign currencies, the overall change of the balance of payments not only affects the foreign reserves of the National Bank, but also other economic agencies, such as private financial institutions, businesses and households.

For 2005, however, exports are still dominated by garments and textile but with lower growth rates. Projected total exports of goods and services for 2005 are US\$2.5 billion, 7 percent higher than 2004, and imports are expected to be 14 percent higher, reaching US\$3.6 billion in 2005. The higher value of imports is due to higher prices, especially of petroleum, that will cause a wider trade deficit gap to 20.5 percent of GDP in 2005. Moderate surpluses from other accounts, especially from the services, FDI, and foreign assistance, will not be sufficient to cover trade deficits so the overall balance of payment will deteriorate.

For 2006, both imports and exports are expected to grow but at a slower rate. Exports of garments and service incomes from tourism will grow at the same pace compared with 2005. Exports of goods and services will continue to increase. Large deficits in trade will worsen the foreign reserve due mainly to an increasing demand for a higher amount of foreign currencies to finance the deficits. As inflows of FDI and foreign aid may not be strong enough, the deficits would threaten foreign reserve and put pressure on the depreciation of the Riel.

## **2.2. Private Investment and Stocks of Capital**

Private investment is one of the country's determinants for growth prospects. EIC's estimates reveal that Cambodia needs no less than US\$1 billion of productive funds including loans and grants to boost both private sector and public infrastructure development and to achieve 7 – 8 percent annual growth of GDP.

EIC estimates that actual implemented private investment in 2004 totaled US\$540 million, 1/3 of which was FDI. Because of limited savings, private domestic investment was flat, whereas FDI picked up more than 50 percent in 2004 compared with that of 2003. The surge in registered projects and fixed assets of investments in garment factories and hotels in 2003 and newly-established factories in 2004 led to higher actual implementation of investment projects in 2004. According to the Council for the Development of Cambodia (CDC), however, newly registered investment projects were less in 2004 than in 2003, both in terms of number of projects approved and fixed assets.

**Table 2.2: Private Investment Projects Approved, 2000-2005**

	2000	2001	2002	2003	2004	Jan-Jun 2005*
<b>Number of Investment Projects Approved</b>						
<b>Total</b>	<b>96</b>	<b>188</b>	<b>37</b>	<b>66</b>	<b>54</b>	<b>56</b>
Garment	52	76	16	31	28	31
Hotel	10	4	4	11	3	2
Others	34	108	17	24	23	23
<b>Fixed Assets Approved (millions of dollars)</b>						
<b>Total</b>	<b>266</b>	<b>217</b>	<b>240</b>	<b>314</b>	<b>217</b>	<b>347</b>
Garment	77	100	18	75	68	50
Hotel	71	71	47	114	24	42
Others	119	46	174	126	125	255

**Source:** CDC, Cambodian Investment Board, \* excluding registered investments of 3 mega projects in oil refinery, iron and steel mining, and aluminum melting whose combined fixed asset is more than US\$3.5 billion.

Data from the first 6 months of 2005 suggests that registered investment projects and fixed assets soared, exceeding the total figure of the whole of 2004. The figure excluded three mega projects whose registered fixed assets are over US\$3.5 billion. However, these projects are long term so that they will not affect the growth prospects of the economy in the short-run. The increase may come after the elimination of the 2 percent of registered-fixed-asset as investment guarantee deposit from early 2005. This would open opportunities for speculative investors<sup>11</sup>, with the ability not to commit to the approved investment projects.

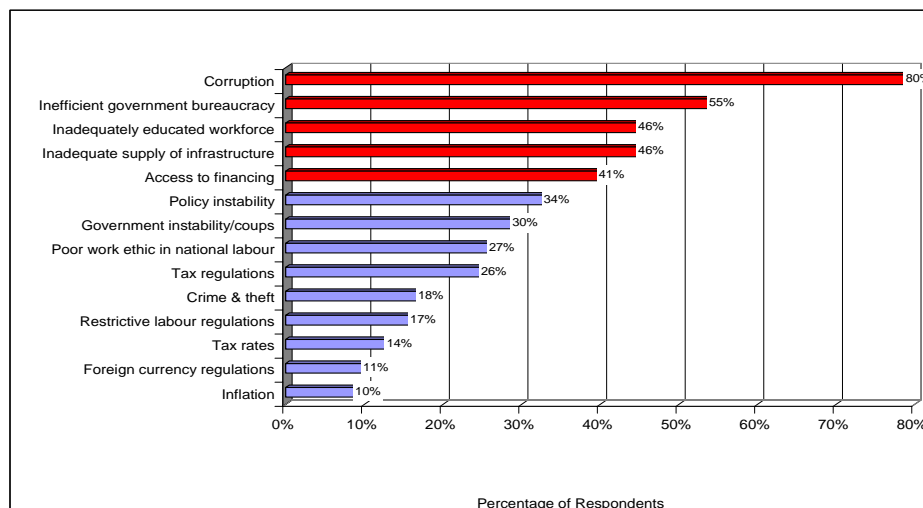
EIC estimates that actual private investment for 2005 will continue to be strong even though construction of new hotels will decline. The garment factories to be built in 2005 are expected to double the number established in 2004 as the safeguard measures taken by the US and EU continue to curb Chinese garment exports from flooding their markets.

Nonetheless, Cambodia will face stiffer competition from Vietnam in both attracting FDI and promoting exports of garments and textile should it become a full member of WTO. Moreover, the slow progress of

<sup>11</sup> Those investors who have no genuine incentives to invest but to get investment licenses and then resell to others in order to make short term profits, commonly known in Khmer as “tver num at msau or making cakes without powders”.

legal, judicial and public administration reforms are still the main obstacles to doing business in Cambodia, according to EIC’s study on the country’s competitiveness. These areas have fostered “corruption as a way of life” and must be dealt with.

**Figure 2.1: The Most Problematic Factors for Doing Business in Cambodia**



**Note:** From a list of 14 factors, respondents were asked to select the five most problematic factors for doing business in Cambodia.

**Source:** EIC, Cambodia Competitiveness Report 2005-2006.

EIC estimates that the stock of capital continues to increase across the sectors but with lower rates for most, except for garments and textile, and tourism the two most dominant and attractive for investment in the country. While the capital stock in agriculture increased by merely 1 percent in 2004 compared with 2003, that of industry and services grew by 8 percent and 10 percent respectively at the same time. Capital stock of garments and textiles increased more than 14 percent and that of hotels and restaurants was 27 percent. The total growth in capital accumulation was 7 percent in 2004.

For 2005, the stock of capital continues to increase due to an exceptional influx of investments in the garment and textile industry even though construction of new hotels will decline. The overall capital stock is expected to increase by 8 percent, 1 percentage point higher than growth in 2004. However, the situation will reverse for the year 2006. While tourism continues to be strong, the garment and textile industry will face uncertainty due to fiercer competitions from rival countries and the uncertain commitment of the government to reducing transaction costs to keep the industries afloat.

### 2.3. Productivity

With low capital stock, Cambodia must maintain a high labor productivity to attract investment such that incremental capital investment would yield higher production and returns. Continuous expansion in garments and tourism has demonstrated the attractiveness and profitability for both domestic and foreign investors.

**Table 2.3: Productivity of Workers (% Increase, US\$2000 price)**

	2002	2003	2004	2005e	2006p
<b>Agriculture</b>	<b>-2.5%</b>	<b>9.1%</b>	<b>-4.6%</b>	<b>-1.4%</b>	<b>1.2%</b>
Paddy	-7.1%	19.0%	-14.7%	-3.1%	2.9%
<b>Industry</b>	<b>8.9%</b>	<b>6.8%</b>	<b>8.1%</b>	<b>5.6%</b>	<b>5.0%</b>
Textile & Garment	14.2%	10.9%	11.4%	9.1%	8.5%
<b>Private Services (*)</b>	<b>2.0%</b>	<b>-0.9%</b>	<b>6.8%</b>	<b>4.2%</b>	<b>4.9%</b>
Tourism	10.3%	-7.7%	8.3%	6.5%	5.2%
<b>Total (*)</b>	<b>2.4%</b>	<b>4.0%</b>	<b>3.7%</b>	<b>2.9%</b>	<b>3.8%</b>

**Source:** EIC Estimates.

(\*) Excluding Public Administration.

According to EIC estimates, productivity of industry and services has been improving gradually over the years. But agricultural productivity on average, especially in paddy rice, fluctuated greatly due to its almost complete dependence on weather conditions. Total productivity increased by more than 3 percent annually during 2002 – 2004 led by productivity gains of the garment and textile industry.

Labor productivity is expected to grow in 2005 but at a lower rate due to a slow down in both garments and textile and tourism sectors. The drought will again dampen the productivity of the agricultural sector. Therefore, labor productivity growth of the whole economy in 2005 will be 2.9 percent, about 1 percent lower than that of 2004. However, the total productivity of labor will recover and grow in 2006 due to better performances across the economy.

The most recent study on the garment industry<sup>12</sup> reveals that among garment factories in Cambodia, the degree of technological and managerial sophistication varies widely. Only 7 percent of Cambodian factories

<sup>12</sup> Measuring Competitiveness and Labor Productivity in Cambodia's Garment Industry, EIC Economic Review, Volume 2, No.2, April – June, 2005.

surveyed operate what could be considered world-class enterprises; more than three-fourths have significant potential for upgrading; and the rest lag behind enough that they will find it difficult to thrive in the post-quota environment of heightened global competition.

However, most factories require both technical and managerial training. Cambodia's apparel factories have tremendous potential for increased productivity provided that they apply sufficient interest, effort, and resources to basic production techniques and managerial disciplines. Improvements in productivity of 15 to 20 percent can be achieved. Along with this productivity gain, Cambodia can move up the value chain to produce higher-quality and higher-value garments.



## Chapter 3

### Prices and Monetary Developments

#### 3.1. Inflation

Price stability is crucial for macroeconomic stability and the livelihoods for the poor because inflation is reflected in the increased cost of living. A sudden increase in prices may benefit some producers and traders. But given limited domestic production and dependence on intermediate imports, inflation would not benefit much the economy as a whole. Moreover, since quite a large proportion of the population has very low income, the higher prices of basic consumer goods simply make the lives of the poor harder.

Inflation has implications for different groups of people and for different parts of the country. For example, while total food consumption accounts for about 65 percent of the total expenditure of the poor, they share less than 40 percent of total expenditure of the rich. Food-inflation raises costs of living and worsens the livelihoods of the poor and those with low income. In many countries, inflation is closely monitored and is used as an indicator for adjustments of cost-of-living allowances to make sure that lives of those who live with meager income will not be affected. The government should take inflation seriously in its salary raise policy and poverty reduction strategy.

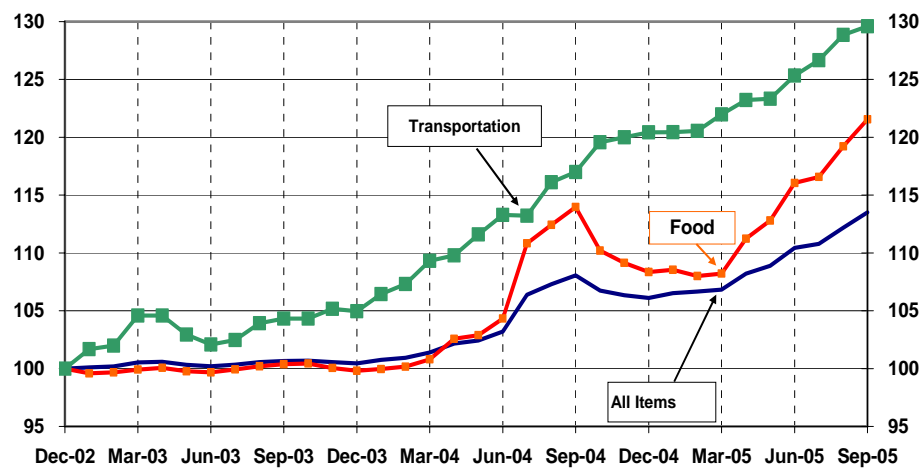
For Phnom Penh, inflation has been on upward trend since the beginning of 2004. The annual average increase of overall prices in Phnom Penh in 2004 was 5 percent higher than that of 2003 which was just at ½ percent. The prices were driven mainly by higher prices of foods, transportation and communications. Food prices are weighted at 39 percent of the overall price index and increased by 9 percent due to jumps in the price of rice, meat, fish, and eggs which rose in the range from 12 percent for rice to 68 percent for cheese fish or “prahok” compared with prices in 2003. Costs of transportation and communications also rose by more than 15 percent caused by a 27 percent rise in the price of gasoline and 38 percent for diesel.

According to NIS figures, inflation remains in the first nine months of 2005. The overall price increased 5 percent in September 2005 compared with that of September 2004. This high inflation was fuelled by an upward trend of food prices and transportation costs. On average, prices of rice rose by 18 percent, where those of meat, eggs and fish increased around 20

percent. The price of gasoline increased 25 percent and that of diesel was 29 percent higher than in September 2004. Average inflation for 2005 is expected to be at 5 to 6 percent and both food prices and transportation will increase by 9 and 10 percent respectively.

The main causes of inflation, especially in foodstuffs, are the reduction in fish stock, drought, and sudden shift of demands for quality meats as a result of the eruption of bird flu in the region. Seasonality is also a factor of price shocks i.e. a ban on large-scale fishing during the reproduction period June – September for upstream Mekong and July – October for the downstream Mekong. In addition, an increase in the prices of petroleum products coupled with a depreciation in the Riel are the cause of higher prices of consumer imports and retail prices of traded commodities as costs to transport them are higher.

**Figure 3.1: Cambodia’s Consumer Price Index (December 2002=100)**



Source: NIS.

EIC studies on the production structure of the economy suggest that petroleum is one of the most important intermediate inputs of production across sectors of the Cambodian economy. Petroleum is 1 percent to 63 percent of the total cost of production among the 22 sectors of the EIC macro-model. According to calculations, by offsetting the increase in sale prices with higher costs of production caused by price increases of petroleum, any 10 percent increase in the price of oil within a year would cause at least a 1 percent net reduction in GDP growth.

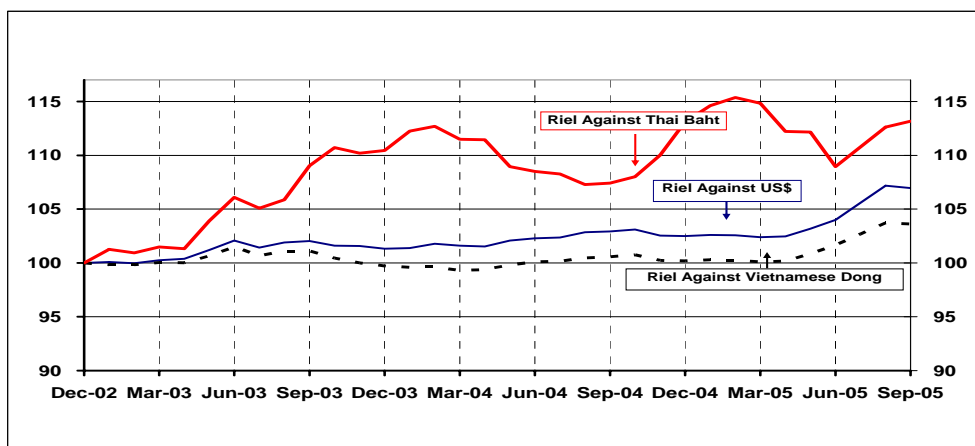
The impacts of the price of oil on consumers’ welfare and cost competitiveness of exporting sectors should be taken into consideration. Given its total dependence on oil imports, Cambodia should establish a national reserve of oil in order to cope with oil shocks. The government

should also rethink its higher taxes on petroleum which are the main cause of increasing oil prices, which are higher than that of its neighboring countries.

### 3.2. Exchange Rate

Normally, exchange rate manipulation is one of the tools to manage the international trade of a country. Depreciation of domestic currency makes prices of exports cheaper and imports more expensive should domestic currency assume its role as a medium of exchange in the country. However, with the prevalence of dollarization, the exchange rate is prone to speculation. Therefore, a fixed or stronger Khmer Riel may be good for the whole economy especially consumers of imports, and there will not be any negative impact on the export performance of the country. However, depreciation of the Riel simply adds higher costs and makes life harder for those who hold it.

**Figure 3.2: Cambodian Riel against US\$, Thai Baht and Vietnamese Dong (December 2002=100)**



Source: EIC, Compiled from IMF-IFS.

According to the International Monetary Fund (IMF) and National Bank of Cambodia (NBC), US\$1 was purchased officially at 4,025 Riel by the end of 2004 compared with 3,976 Riel per US\$ that of 2003. The market rate ranged between 5 Riel to 10 Riel higher than the official rates. The Riel continued to weaken for the first half of 2005, depreciated about 2 percent compared with the end of 2004. The exchange rate of the Riel against the Thai Bath was 103 Riel per Bath by the end of 2004 compared with 100 Riel per Bath at the end of the year before. The rate was down to 101 Riel per Bath by the end of September 2005. The value of the Riel against the Vietnamese Dong was less volatile during the same period.

The weakening of the Riel against US\$ was caused mainly by a sharp economic slowdown in rural areas, where the national currency is mostly used. It is also caused by the widening of trade deficits in 2004 compared with 2003. Surges in imports especially for construction materials and vehicles and higher prices of imported petroleum were factors causing stronger demand for foreign exchange, especially the US\$. Moreover, repatriation of US\$ abroad and speculations are also behind the fluctuations of the Riel against the US\$. The current expansion of imports will put further pressure on the depreciation of the Riel in 2005. The average exchange rate of the Riel against US\$ in 2005 will stay around 4,200 Riel per US\$ compared with 4,025 Riel in 2004 or 4 percent depreciation

The central bank should take effective measures to either stabilize or strengthen the exchange rate to protect those who hold Riel from loss. Only with the stability of the Riel combined with regulatory measures, then will Riel-denominated transactions be feasible. The confidence in Riel as a medium of exchange in the economy will enable the central bank to retain its monetary policy. However, independence and effective implementation of monetary policy are separate issues. Capacity and institutional arrangements in terms of physical, human and legal infrastructures should be first in place before the central bank can take command of its own policy tools.

### **3.3. Money Supply**

In well-established financial markets, demand and supply for money are closely linked with interest rates, one of the fundamental transmission mechanisms of monetary policy. But money supply and demand in Cambodia are largely dependent on seasonal executions of the government budgets, political situations, speculations, and partially on interest rates. Since the US\$ is predominant on the market, fluctuations in exchange rate signal actual demand and supply for dollars and Riel.

In 2004, total money supply continued to expand by 30 percent compared with 2003 and to reach more than 22 percent of GDP. The increase in foreign currency deposits was attributed to the hike, while the use of local currency was still limited. In fact, foreign currency deposit surged by 33 percent and Riel in circulation also increased by 23 percent in 2004 compared with that of 2003. The trend is expected to continue for 2005 and 2006, but at a lower pace.

**Table 3.1: Cambodia's Monetary Survey (End of Period, Billion Riel)**

	2002	2003	2004	2005e	2006p
<b>Total Money Supply</b>	<b>2,888</b>	<b>3,329</b>	<b>4,329</b>	<b>5,010</b>	<b>5,728</b>
Local Currency in Circulation	766	908	1,115	1,205	1,349
Foreign Currency Deposits	2,001	2,310	3,079	3,643	4,188
Other Money Supply	122	111	135	162	192
<b>Total Money Demand</b>	<b>2,888</b>	<b>3,329</b>	<b>4,329</b>	<b>5,010</b>	<b>5,728</b>
Credit to Private Sector	1,059	1,337	1,817	1,970	2,141
Credit to Public Sector	(117)	(128)	(209)	(192)	(176)
Others (*)	1,947	2,120	2,722	3,232	3,763

**Source:** National Bank of Cambodia for 2002-2004, EIC model projection for 2005-2006.

(\*) This item represents mostly the money sent abroad.

The total amount of money, especially foreign currency deposits which were available were either lent to domestic borrowers or sent abroad. The latter accounted for a larger proportion of total money demanded. Credits to public sectors continue to decline due to an increase in government deposits. In 2004, total credit to the private sector increased by 36 percent, 10 percent higher than the growth rate of 2003. This credit expansion was the result of lower interest rates in 2004 compared with 2003, and the growths in manufacturing and service sectors. The trend is expected to carry over into 2005 and 2006, but at a slightly lower pace.

However, higher risks and interest rates on loans make it difficult for domestic borrowers to access credits. Therefore, large amounts of foreign currency deposits have to flow overseas. Lack of credit access for domestic enterprises and small businesses is one of the main constraints for private sector development in Cambodia. According to EIC surveys, high interest rates on lending coupled with high transaction costs discourage small and medium enterprises (SMEs) from expanding their operations. For financial institutions, informality of the businesses, lack of legal infrastructure, and poor law enforcement are factors behind higher risks of lending and uncertainty that force banks to charge higher rates.

### 3.4. Interest Rates

The interest rate is the most important and effective transmission mechanism of monetary policy in developed financial markets. The interest

rate reflects costs of utilization of funds through which it affects demand and supply for money. An underdeveloped financial system and lack of confidence in the banks have narrowed sources of funding in Cambodia. Higher rates of interests are the only option for banks to mobilize resources and funds in addition to their initial capital requirements.

**Table 3.2: Cambodia's Interest Rate (% per annum, end of period)**

	2002	2003	2004	June 2005
<b>Riel 12-months Deposits Rate</b>	7.2	7.0	6.6	6.6
<b>US\$ 12-months Deposits Rate</b>	4.2	4.0	3.7	3.7
<b>Riel 12-months Lending Rate</b>	21.0	21.1	18.7	18.6
<b>US\$ 12-months Lending Rate</b>	18.2	17.3	16.7	16.7
<b>Inflation rate (year on year, in riel)</b>	3.0	0.5	5.6	7.0
<b>Inflation rate (year on year, in US\$)</b>	3.1	-1.0	4.7	4.5

*Source: National Bank of Cambodia and NIS.*

According to data from the National Bank of Cambodia (NBC), annual interest rates on deposits in Riel and US\$ were quite high, while the rates on lending were more than 10 percent over the deposit rates. Interest rates in Riel were higher than that of US\$ due to mainly risks from its depreciation. However, with a gradual confidence in the financial system and economic expansion for the last decade, banks have pulled down both deposit and lending rates.

Evidently, the lower rates have encouraged private sectors to seek alternative funds from borrowing to enlarge their business operations in recent years. But most large loans are given to formal sectors especially in industry, construction, and services, which are still concentrated in urban areas. The remaining financial operations are covered by growing microfinance institutions led by ACLEDA bank. EIC's consultations with local and smaller businesses suggest that lower rates of lending, around 2 percent per month, will encourage more small domestic businesses to expand their operations.

## Chapter 4

### Fiscal Development and External Debts

#### 4.1. Budget Revenue

Budget revenue reflects effective and efficient public finance mobilization needed for public service deliveries. The main sources of budget income are from taxes and non-taxes such as service charges from public utilities, rental of public assets, concession fees from exploitations of natural and cultural resources, and other revenues from public service deliveries (both tangible and intangible).

**Table 4.1: Cambodia's Government Revenue (Billion Riel)**

	2002	2003	2004	2005e	2006p
<b>Total Domestic Revenue</b>	<b>1,762</b>	<b>1,765</b>	<b>2,127</b>	<b>2,356</b>	<b>2,588</b>
<b>Tax Revenue</b>	<b>1,249</b>	<b>1,220</b>	<b>1,577</b>	<b>1,857</b>	<b>2,069</b>
Profit Taxes	97	110	117	130	149
Excise Taxes	210	198	304	384	412
Value Added Taxes	452	460	598	693	780
Trade Taxes	424	395	513	605	679
Other Tax Revenue	66	57	44	44	49
<b>Non-tax Revenue (1)</b>	<b>513</b>	<b>545</b>	<b>549</b>	<b>499</b>	<b>519</b>
Contribution from Tourism (2)	93	83	103	107	127
Quota & Export Licenses	106	146	76	25	25
Posts & Telecommunication	121	120	94	112	125
Other Revenue	192	196	275	255	242
<i><b>Memorandum Items</b></i>					
<i>Taxes on Petroleum Products</i>	<i>322</i>	<i>294</i>	<i>335</i>	<i>358</i>	<i>379</i>
<i>Tax Department Revenue</i>	<i>298</i>	<i>345</i>	<i>405</i>	<i>448</i>	<i>519</i>
<i>Customs Department Revenue</i>	<i>952</i>	<i>875</i>	<i>1,173</i>	<i>1,408</i>	<i>1,551</i>
<b>Total Domestic Revenue (% of GDP)</b>	<b>11.0%</b>	<b>10.2%</b>	<b>10.8%</b>	<b>10.7%</b>	<b>10.6%</b>

**Source:** Ministry of Economy and Finance for 2002-2004, and EIC model projection for 2005-2006.

(1) Including Capital Revenue.

(2) Including Tourism Incomes, Civil Aviation and Visa Fees.

In 2004, the government achieved its budget target again after half a decade. Actual current revenue was slightly higher than the target due largely to tax revenue which was more than 29 percent higher than the amount collected in 2003. Both collections of VAT and taxes on international trade increased by 30 percent. Excise duties were also up about 50 percent compared with 2003. However, non-tax revenue was below the budget target due to a huge decline in income from quota auction, tourism (visa fees and concessions), and post and telecommunications.

Nonetheless, overall budget revenue in terms of GDP recovered and almost reached 11 percent of GDP in 2004, back to its peak level in 2002. This ratio of budget revenue to GDP is still the lowest compared with other developing countries. Even with gradual improvements in revenue mobilization, leakages are still large due to smuggling and tax evasion.

For example, while the estimated import of petroleum by NIS was more than US\$600 million in 2004, total tax revenue from petroleum products was just US\$84 million. This revenue included the collection of VAT tax, excise duties and other taxes (compound tax rate was 108 percent for gasoline and 52 percent for diesel<sup>13</sup>). Revenue from visas was US\$15 million and from tourism fees was US\$7 million in 2004, while the number of tourist arrivals was 1 million (visa fee is US\$20 per person and fees to visit Angkor Wat complex per person is US\$20 per day and US\$35 for 3 days).

Moreover, there are other potential budget revenues the government has yet to consider. Since most tax revenues are from indirect taxes and taxes on imports, consuming households have to bear most of the tax burdens (90 percent) as direct taxes accounted for just 10 percent of the total tax revenue in 2004. There are some loopholes in tax exemptions and unnecessary tax holidays that cost the country millions of US\$.

Yet, revenue from taxes on large-scale idle lands<sup>14</sup> and property are negligible. Weak enforcement of tax laws is one of the factors which encourages land speculations and land grabbing. This consumer-based structure is biased against the poor, thus needs to be reconsidered. Should taxes be duly collected, the government could reduce the tax burden on the poor (pro-poverty-reduction tax) by lowering taxes on basic consumptions and on petroleum.

---

<sup>13</sup> IMF (2004). Cambodia Selected Issues. p. 82

<sup>14</sup> Ministry of Economy and Finance. Prakas No. 162 on Establishment of Working Group on Stamp Tax and Taxes on Unused Lands dated 15/03/2005. No actual enforcement is identifiable.

According to official data for the first eight months of 2005, budget revenue continues to increase and is likely to meet its target. Tax revenue increased by 22 percent compared with the first eight months of 2004 and reached 68 percent of the budget target. Surprisingly, all taxes (VAT and Import Duties) on petroleum were 23 percent lower than for the first eight months of 2004, while petroleum imports (except diesel) increased significantly compared with that of 2004. Non-tax revenue increased however only very slightly. If the trend can be maintained till the end of the year, total revenue will reach the budget target for 2005.

However, the target of budget revenue was set on low economic growth 2 – 3 percent for 2005. Should the growth scenario be more than 6 percent as forecasted by the government, the revenue must be higher. Therefore, the current good tax collection is just a simple phenomenon.

#### **4.2. Budget Expenditure**

The purpose of budget expenditure is to provide public services mainly national security, fundamental infrastructure and utilities, basic needs and social safety nets such as the most basic access to education and health care. In other words, the budget must be enough to provide public goods and services and to compensate negative “externalities” to maximize social welfare such as equitable distribution of income and equal opportunities for all.

With this regard, the government has made concerted efforts in reforming its public financial management to transform the budget as a tool to implement government policy. The government intends to reduce spending on security and defense and to increase budgets for health, education, agriculture, and rural development, the priority sectors.

In 2004, overall expenditure increased by 7 percent but its share of GDP was lower than that of 2003, since nominal GDP was much higher. On average, spending on priority sectors rose by 8 percent while those on the remaining ministries increased by 20 percent. However, expenditure on defense and security in 2004 was just 2 percent higher than the amount spent in 2003. As a share of GDP, the budget released for defense and security declined from 2.4 percent in 2003 to 2.2 percent in 2004, whereas expenditure on civil administration increased slightly. The share of spending on priority sectors reached only 2.9 percent of GDP against the 3.6 percent target set by the government.

**Table 4.2: Cambodia's Government Expenditure (Billion Riel)**

	2002	2003	2004	2005e	2006p
<b>Total Expenditure</b>	<b>2,770</b>	<b>2,757</b>	<b>2,962</b>	<b>3,333</b>	<b>3,593</b>
<b>Current Expenditure</b>	<b>1,579</b>	<b>1,586</b>	<b>1,769</b>	<b>2,004</b>	<b>2,260</b>
<b>Civil Administration</b>	<b>1,192</b>	<b>1,175</b>	<b>1,346</b>	<b>1,497</b>	<b>1,680</b>
Priority Sector (1)	512	529	573	665	757
Other Civil Ministries	680	646	773	832	923
<b>Defense &amp; Security</b>	<b>387</b>	<b>411</b>	<b>423</b>	<b>507</b>	<b>580</b>
Defense	245	270	272	329	374
Security	142	141	151	178	206
<b>Capital Expenditure</b>	<b>1,191</b>	<b>1,171</b>	<b>1,193</b>	<b>1,329</b>	<b>1,333</b>
Through National Treasury	288	333	296	407	371
Direct External Financed	903	838	896	922	962
<i>Memorandum Items</i>					
<i>Wages</i>	<i>586</i>	<i>615</i>	<i>640</i>	<i>741</i>	<i>848</i>
<i>Non-Wages Operating Costs</i>	<i>993</i>	<i>971</i>	<i>1,130</i>	<i>1,263</i>	<i>1,413</i>
Priority Sectors (% of GDP)	3.2%	3.1%	2.9%	3.1%	3.1%
Defense & Security (% of GDP)	2.4%	2.4%	2.2%	2.3%	2.4%

**Source:** Ministry of Economy and Finance for 2002-2004, and EIC model projection for 2005-2006.

(1) Including Health, Education, Agriculture, and Rural Development.

Poor public expenditure is one of the main obstacles in improving public service deliveries due to inadequate operational funds and low salaries of public servants. Low wages have discouraged qualified Cambodians from serving in the public sector and encouraged existing qualified public servants to leave the public sector and seek employment opportunities elsewhere.

For the first eight months of 2005, expenditure reached only 56 percent of the budget level. Most of the ministries' spending was below 68 percent of their allocated budget. Salary payments were about 57 percent of the budget and non-wage disbursement was just 50 percent of the annual earmark. A slow reporting process from line ministries may be a reason for the low figures. However, overall expenditure in 2005 is expected to reach the target given better revenue performance. Budget disbursement as a share of GDP for priority sectors may reach 3.1 percent and will slightly increase for wages but will still be below the target.

Even though, the government has recently declared a salary raise for its bureaucrats<sup>15</sup>, only its already “relatively-well-off<sup>16</sup>” public servants will benefit from the raise while most still live far below a “decent wage”. For that reason, morale of normal public servants continues to be low and they keep “moonlighting” just to survive. Unless salaries can be raised for all public servants to a decent level, public service deliveries will not be much improved. The raise can only be done through reduction of large revenue leakages and wastage in unnecessary expenditures.

### 4.3. Budget Financing

In developing countries, under-collection of budget revenue results in a shortage of funds to meet public expenditures. Budget revenue is too low to cover both current (basic operations) and capital expenditure (infrastructure and public investment). The deficits need to be financed through domestic and international borrowing and foreign assistance.

**Table 4.3: Cambodia's Financing Budget (Billion Riel)**

	2002	2003	2004	2005e	2006p
<b>Total Domestic Revenue</b>	<b>1,762</b>	<b>1,765</b>	<b>2,127</b>	<b>2,356</b>	<b>2,588</b>
<b>Total Expenditure</b>	<b>2,770</b>	<b>2,757</b>	<b>2,962</b>	<b>3,333</b>	<b>3,593</b>
<b>Total Deficit (cash basis)</b>	<b>-1,008</b>	<b>-992</b>	<b>-835</b>	<b>-977</b>	<b>-1,005</b>
<b>Foreign Financing (1)</b>	<b>1,074</b>	<b>886</b>	<b>894</b>	<b>977</b>	<b>1,005</b>
Grants	451	382	372	410	437
Loans (net)	622	504	522	567	568
<b>Domestic Financing</b>	<b>-65</b>	<b>106</b>	<b>-59</b>	<b>0</b>	<b>0</b>
Banks	-104	-3	25	0	0
Others	38	109	-84	0	0
<i>Memorandum Items</i>					
<i>Net Foreign Reserves at NBC</i>	<i>2,267</i>	<i>2,539</i>	<i>2,707</i>	<i>2,782</i>	<i>2,858</i>

**Source:** Ministry of Economy and Finance for 2002-2004, and EIC model projection for 2005-2006.

(1) Including only project aid.

In 2004, the total deficit was lower than that of 2003 because of improvements in budget revenue. The deficit was 4.3 percent of GDP

<sup>15</sup> Sub-decree No.96 ANK.BK, effective from August 01, 2005

<sup>16</sup> EIC's sporadic interviews and observations confirmed that majority of government officials from the rank of deputy director of a department or above are already better-off compared with normal officers. Most of them have been enjoying extra benefits such as monthly gasoline allowances.

down from 5.7 percent in 2003 and from more than 6 percent in 2002. The main sources of deficit financing are from foreign grants and loans of which the latter shares a higher proportion. Of particular notice, bilateral loans keep increasing from US\$20 million in 2003 to US\$29 million in 2004. As the central bank has refrained from financing government deficits, domestic financing is done through selling of Treasury bills and other domestic borrowings. In 2004, the government did not borrow in recent years but was able to repay its liabilities to the private sector. However, the government will continue to depend on foreign assistance and some private loans to meet its budget shortages in the following years.

#### **4.4. Foreign Aid and External Debts**

Flows of aid from advanced to war-inflicted and poorer countries are common practices whether done for world commitments to reduce poverty, humanitarian, or political reasons. Aid is delivered in different forms: bilateral, multilateral, grants or loans to deal with financial constraints of recipient countries. However, the nature and effectiveness and efficiency of aid needs closer scrutiny. The utilization of foreign borrowings is important to ensure proper value for money and viable management of debts.

Since 1993 after the peace settlement and general election, Cambodia has been enjoying large inflows of foreign aid to rebuild the country, totaling US\$5.66 billion by 2003. Most assistance in the past decades focused on multifaceted institutional and technical assistance (TAs), and the rest on social sectors and infrastructure rehabilitation. Terms of aid deliveries have shifted from grants to loans as the share of grants in the total aid decreased from 89 percent in 1993 to 73 percent in 2003, whereas loans increased from 13 percent of the total aid flows to 26 percent during the same period<sup>17</sup>.

Due to a lack of government technical capacity, TAs increased from 24 percent of total aid in 1993 to 50 percent in 2003<sup>18</sup>. On average, 50 percent of the total aid was on health, education, and infrastructure development, while aid to agriculture was less than 10 percent per year. These assistances have greatly contributed to the reconstruction of Cambodia, boosting economic growth, financing trade and budget deficits and, to some extent, to alleviating poverty.

However, the effectiveness of assistance has been raised by both the donor community and the government. Poverty is believed to remain

---

<sup>17</sup> Council for Development of Cambodia. 2004. *Development Cooperation Report 2002 and 2003*. p.15

<sup>18</sup> International Monetary Fund. 2004. *Cambodia: Selected Issues*. p. 62

widespread. Both the physical and social infrastructure of the country are still lagging behind neighboring countries. More emphasis should be given to investment in agricultural development, health care, education, and fundamental infrastructure. Technical assistance should be reduced and be done either by Cambodian professionals or in partnership between foreign and local experts.

As Cambodia continues to borrow abroad to meet cash limitations, proper debt management is necessary to ensure financial viability of the country. According to the IMF, total public external debt was estimated to be US\$3 billion (including debt owed to the US and Russia before 1993) by 2003 and debt services was US\$71 million<sup>19</sup>. Cambodia is negotiating with the US and Russia for debt forgiveness and rescheduling. But as Cambodia is starting to pay interest on loans borrowed after 1993, more funds are needed for debt services. This will exacerbate the current scarcity of funds for development unless domestic revenue is strengthened to reach around 15 percent of GDP or more, annually.

---

<sup>19</sup> International Monetary Fund. (2004). *Cambodia: 2004 Article IV Consultation – Staff Report*. p. 31



## Chapter 5

### Labor Force, Incomes, and Poverty

#### 5.1. Labor Force and Under-employment

The share of employment in formal sectors such as garment industries, tourism, and other emerging new industries is small compared with that of the informal sector which accounts for more than 90 percent of the total employment. Therefore, improving productivity in the latter is vital to absorb new entrants into labor markets and to curb migration to cities and illegal border-crossings to seek employment in neighboring countries.

According to EIC's preliminary estimates, new entrants into the labor force have increased by 3.5 percent annually since 2001. However, job creation is lower than the increase in labor force, even though new jobs created by formal sectors have been quite strong. Low productivity and unpredictability of the informal sector has generated low employment opportunities. As a result, the unemployment rate has increased sharply since 2001.

In order for unemployment to decline, 300,000 new jobs have to be created every year. As formal sectors can generate about 50,000 jobs at best, the rest of the new entrants must go to the informal sectors or to seek job opportunities elsewhere. Only expansion in agriculture and other labor-intensive industries can absorb the oversupply of the labor force.

#### 5.2. Income Distribution

Distribution of income reflects the share of gains from economic growth. Distribution patterns differ according to “capability”<sup>20</sup> of socioeconomic agents to directly participate in economic activities (the market mechanism) and indirectly through the legitimate reach of social benefits provided by the public sector (public service deliveries).

The main sources of income generation are from land tenure, labor participation, ownership of capital, and know-how technology. By itself “development will not change the distribution of innate ability, and therefore will not change the distribution of income”<sup>21</sup>. Complementary

---

<sup>20</sup> Sen, Amartya. (1999). *DEVELOPMENT AS FREEDOM*. p.87. Oxford University Press.

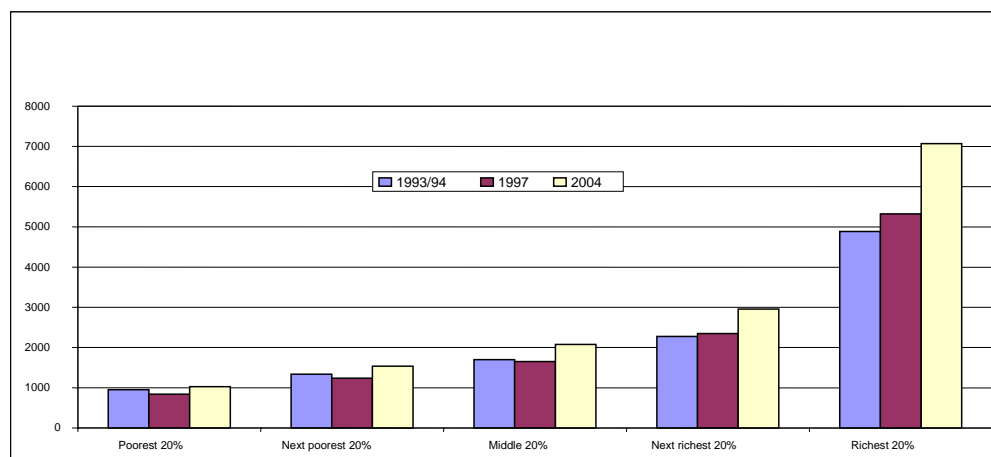
<sup>21</sup> Meier, G.M., and Rauch, J.E. (2000). *Leading Issues in Economic Development*. p.375, 7<sup>th</sup> Ed. New York and Oxford: Oxford University Press.

reform measures by the government must be in place to redistribute gains from economic growths.

According to EIC studies, labor income in agriculture, on average, increased 3 percent during 1999 – 2004, slightly above the population growth rate, while that of industry and the service sectors grew by 14 percent and 8 percent respectively in the same period. Figure 5.1 reveals that while income reflecting by per capita consumption of 40 percent of the poorest increased slightly, that of the 20 percent richest increased sharply from 1997 – 2004. As growth in agriculture, where most of the rural poor depend on, was very low compared with urban industrial and service sectors, the gap between the rich and the poor has become wider

Obviously, income generation in Cambodia is largely from land use for agriculture and labor participation given cheap labor costs, scarcity of initial capital investment, poor infrastructure and lack of technology. Policy responses should be on land distribution, rapid infrastructure development, and greater emphasis on investment in health and education. Most importantly, failure to address appropriate land distribution and impediments to stable growth in agriculture will cause the income gap to widen and poverty reduction is unlikely to occur.

**Figure 5.1: Mean Real Household Consumption Per Capita By Per Capita Consumption Quintile (1993/94 Phnom Penh Prices)**



**Source:** Chan Sophal, *The World Bank*, presented at EIC Project Launch Meeting on “Trade, Development and Poverty Reduction, Aug 23, 2005.

### 5.3. Poverty

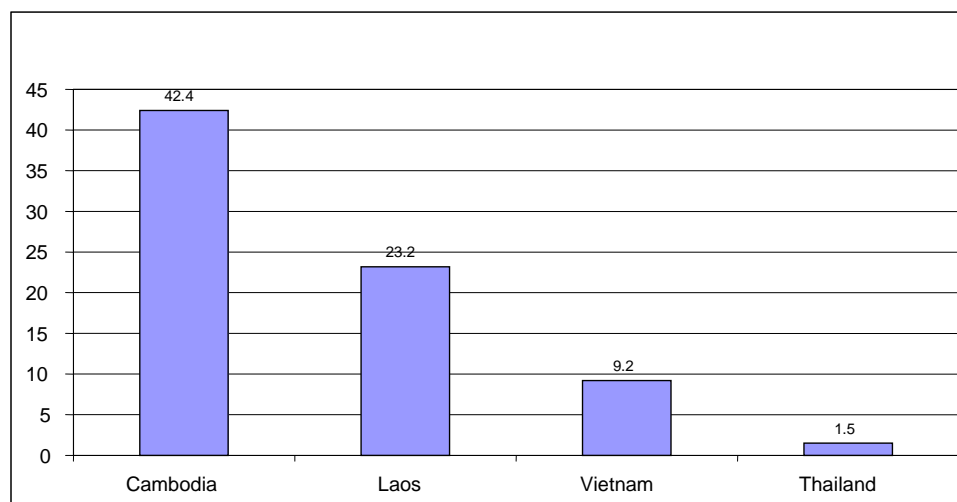
As analyzed above, low growth in the agricultural sector and concentration of growth in garments and tourism have a marginal impact on income distribution and poverty reduction in the country. The poverty

rate was 36 percent in 1999 and the latest rate is not yet available. Results from the socioeconomic survey for 2003-04 are under preparation.

Available estimates by the World Bank and other institutions suggest that poverty may be reduced indirectly by good performances in the garment and tourism sectors. However, if the US\$1 poverty line were applied, then the Cambodian poverty headcount would be 42 percent in 2004, the highest compared with her neighboring countries. The poverty line in Cambodia is set at around 2,350 Riel per capita per day for Phnom Penh, 1,950 Riel for other urban areas and 1,750 Riel for rural areas in 2004. Another year of severe drought and a forecast 5 percent of inflation in 2005, especially an increase in food prices, are another blow for the poor.

The main obstacles to poverty reduction are the same as identified by the government in 2002<sup>22</sup>. The most recent survey on four different districts across the country<sup>23</sup> suggests that parts of the country, especially new integrated regions formerly controlled by the Khmer Rouge, have enjoyed a high increase in income due to large distributions of land for each household. However, areas with a prevalence of landless and limited access to common property resources such as forest and fisheries are worse off.

**Figure 5.2: Percentage of People Living on Less Than US\$ 1 a Day in 2004**



**Source:** *The World Bank East Asian Update (April 2005).*

There are no other suggestions except furnishing the measures that have been already prescribed by the government itself in poverty reduction and the Rectangular Strategy. The most urgent actions, however, are the reforms in land management with particular emphasis on the landless,

<sup>22</sup> Royal Government of Cambodia. (2002). *National Poverty Reduction Strategy 2003 – 2005*. p. iii

<sup>23</sup> EIC's Cambodia Poverty Assessment: Regional Case Studies, sponsored by the World Bank.

reforms in public finance to prevent revenue leakages and wastages, legal judicial and public administration to provide a viable environment for private sector development, and more investments are needed in physical and social infrastructure.

**Part  
II**

**STRUCTURAL REFORMS:  
CURRENT IMPLEMENTATION  
AND PROSPECTS**



Concentration of growth and marginal trickle down effects of economic growth on income distribution and poverty reduction in the past decade requires an acceleration of reforms across sectors. Development will not change the distribution of innate ability, and therefore will not change the distribution of income. Direct reforms that help redistribute gains from economic growth are in the areas of land and natural resource management whereby the poor will benefit, whereas those in legal and judicial systems, public administration, banking, finance, public finance, trade will improve both enabling the environment for the private sector to lead growth, job creations, and better public service deliveries.



## Chapter 6

# Banking and Financial Sector Reforms

The reform of the banking and financial sector completed its phase one at the end of 2004 and kicked off phase two in 2005. Some progress has been made during 2001-2004, especially in laying out a regulatory and supervisory framework for the banking and financial sector. Thus, this part will examine progress, impacts and remaining issues after phase one implementation with restriction to three critical sectors: banking, rural finance and insurance.

### 6.1. Banking Sector

All banks have been well capitalized and the banking system has been subjected to a regulatory and supervisory regime. The National Bank of Cambodia regularly monitors commercial banks through both off-site surveillance and on-site inspection. As a result from this supervision, NBC found some major shortcomings such as a short fall in net worth, a deficiency in the capital guarantee deposits, a low insolvency ration, a high ratio of investment in fixed assets, and a high prepayment for rent and leases. Several more NBC *Prakas* were issued in 2004 to enhance commercial bank supervision.<sup>24</sup>

Implementing the Banking and Financial Institution Laws and the Financial Sector Blueprint produced some positive impacts on the banking sector. The sector appears to have a stable system, and to be on track and healthy growth. By September 2005, the number of commercial banks increased up to 15 from 14 in 2002 including one state-owned bank. Some commercial banks have expanded their operations to some major provincial cities. Yet, their expansion is concentrated in only three major cities Siem Reap, Sihanouk Ville and Battambang where demand for banking services is growing.

Commercial banks' role as an agent for financial intermediation has improved and seemed to bring back public confidence from both individuals and corporations. Total deposit posted a 33 percent increase in 2004 (from CR 2,420 billion in 2003 to CR 3,209 billion in 2004) compared

---

<sup>24</sup> (1) *Prakas* on payments of dividends in advance; (2) *Prakas* on prepaid prepayments on rental and leases; (3) *Prakas* on requirement in compliance with fact and substance; (4) *Prakas* on amendments relating to liquidity; (5) *Prakas* relating to the banks' solvency ratio; (6) *Prakas* on the annual audit of financial statements of banks and financial institutions; (7) *Prakas* on license fees for banks and financial institutions; (8) Circular on installment loan classification and provisioning; (9) Circular on non-performing loans, provisions and interests accounting.

with a 22 percent increase in 2001 (from CR 1,335 billion in 2000 to CR 1,626 billion in 2001, a period before commencing blueprint implementation).<sup>25</sup> Similarly, during the same comparison period total credit provided by banks rose 36 percent (from CR 1,369 billion in 2003 to CR 1,869 billion in 2004) compared with an 8 percent rose (from about CR 908 million in 2000 to CR985 million in 2001).

**Table 6.1: Commercial Bank Expansion**

<b>Banks</b>	<b>Branches in the Provinces</b>
<b>Commercial Bank</b>	
Advanced Bank of Asia	Not yet
ACLEDA Bank Ltd	All 22 provinces and towns with 136 branches
ANZ Royal Bank Cambodia Ltd.	Not yet
Cambodia Asia Bank	Not yet
Canadia Bank Ltd.	Sihanouk Ville, Battambang, Kampong Cham, Pailin, Siem Reap, Poipet and Kampot
Cambodian Commercial Bank	Battambang and Siem Reap
Cambodian Mekong Bank	Siem Reap and Sihanouk Ville
Cambodian Public Bank	Siem Reap
Singapore Banking Corporation	Not yet
Union Commercial Bank	Sihanouk Ville, Siem Reap & Battambang
Vattanac Bank	Siem Reap
First Commercial Bank	Not yet
Krung Thai Bank	Siem Reap
May Bank	Not yet
Foreign Trade Bank	Not yet
<b>Specialized Banks</b>	
Rural Development Bank	Not yet
Peng Heng S.M.E Ltd	Not yet
Cambodia Agriculture Industrial specialized bank	Not yet
<b>Representative Office</b>	
Standard Chartered	

**Source:** NBC Quarterly Review 13.

<sup>25</sup> According to National Bank of Cambodia's Annual Report, Appendix 7, Table 7.

Despite these achievements, commercial banks still play limited roles in facilitating investment, particularly in providing loans. According to a survey by EIC as a partner of World Economic Forum in February-March 2005 with 100 top businesses executive 80 percent of respondents said it was difficult to access loans from commercial banks if they do not have collaterals (Chan & Sok, 2005). The insufficient lending to business is due to such major reasons as (i) weak credit risk assessment capacity of these commercial banks; (ii) unavailability and in some cases unreliability of borrower information; (iii) absence of financial contract enforceability.

**Table 6.2: Recent Developments in Banking Sector**

Progress	Remained Issues
<ul style="list-style-type: none"> <li>▪ Completed bank re-licensing program. Capitalized banking system</li> <li>▪ Established regulatory and supervisory regime. In 2004, 13 banks out of 14 banks implemented COAs. Starting from 2005, required banks to issue annual reports audited by external auditing firms</li> <li>▪ Issued more <i>Prakas</i> and <i>Circular</i></li> <li>▪ Implemented full on-site supervision in 2004 with well trained staff using CAMELS methodology</li> <li>▪ Carried out off-site surveillance by examining financial reports and annual auditing report on commercial banks compliance with NBC's legislation, regulations and instructions</li> <li>▪ Improved financial intermediary services</li> <li>▪ Obtained increasing public confidence in banking services</li> </ul>	<ul style="list-style-type: none"> <li>▪ Having limited roles in facilitating private investment and in providing loans to rural areas</li> <li>▪ Lacking credit assessment capacity of commercial banks</li> <li>▪ Delaying enactment of negotiable instruments and payment transactions, company law, bankruptcy law, secured transactions law and law on money laundering and combat terrorism financing, and securities and exchange law</li> <li>▪ Implementing full adoption of COAs</li> <li>▪ Delaying FTB privatization</li> <li>▪ Further encouraging public confidence in banking system and services</li> <li>▪ Further encouraging financial intermediary services</li> </ul>

**Source:** *Cambodia Economic Watch (2005) and NBC Annual Report 2004.*

Although commercial banks started to expand their branches to some major provinces, they appeared to engage little in providing small loans to the rural economy. Among 15 commercial banks, only Canadia and ACLEDA (which used to operate as an MFI before December 2003) operate rural finance activities.

Furthermore, a sound and strong foundation of the banking system has not yet been established as major pieces of legislation remained in draft

forms: Bankruptcy law, secured transaction law and the law on anti-money laundering and combating terrorism financing.

## 6.2. Rural Finance

Rural finance is also observed to have progressed after implementing the law on banking and financial institutions and the blueprint. The government has made efforts to establish regulations and instructions for rural finance operators. For instance, MFIs and registered NGOs are subject to both off-site surveillance and on-site inspections as they need to submit various financial reports regularly to the National Bank of Cambodia (NBC).<sup>26</sup> As a result, rural finance sector reform impacts significantly in integrating MFIs and NGOs into a formal financial system. Just less than a year from September 2004 to June 2005, two MFIs – Prasac Micro Finance Institution and the Farmer Union Development Fund – obtained licenses from NBC; Volunteer Career Development Community registered with NBC.

**Table 6.3: Recent Developments in Rural Finance Sector**

Progress	Remained Issues
<ul style="list-style-type: none"> <li>▪ Established regulatory and supervisory regime. Issued several <i>Prakas</i> and instructions</li> <li>▪ Commercialized and transformed MFIs to formal financial system by encouraging rural credit operators to obtain license and to register with NBC</li> <li>▪ As of 30 June 2005 number of licensed MFIs is 11, up from 9 as of 30 September 2004</li> <li>▪ As of 30 June 2005, number of registered NGOs is 31, up from 30 as of 30 September 2004</li> <li>▪ Carried out off-site surveillance and on-site inspection on licensed MFIs and registered NGOs</li> </ul>	<ul style="list-style-type: none"> <li>▪ Registration of all rural credit operators is not yet completed</li> <li>▪ Improving regulation and supervision capacity of NBC</li> <li>▪ Regulations to protect depositors have not yet developed.</li> <li>▪ Limitation of household access to rural credits, especially remote area. Insufficient deposits in rural credit operators. As of June 2006, total loans was US\$77 million to about 392,892 borrowers; total deposits was US\$23 million from about 155,137</li> <li>▪ Encouraging commercial banks to engage in rural credit operations</li> </ul>

**Sources:** *Cambodia Economic Watch (2005)*, *NBC Annual Report (2004)*, *NBC Quarterly Review 11, 12 & 13 and CGAP (2005)*.

Nonetheless, access to credits especially households in remote areas is still limited. As of June 2004, the CGAP report stated that MFIs and

<sup>26</sup> For further details of types of reports, please see *Cambodian Economic Watch*, April 2005, footnote 42, page 47.

registered NGOs had provided loans amounting to US\$77 million to 393,000 borrowers. This provision is far lower than the demand of US\$120 million- US\$130 million which was estimated by NBC in 2002 (UNDP, 2004). Deposits are also at a low level as total savings in MFIs and registered NGOs collected around US\$23 million of which former rural finance operator, ACLEDA bank, accounted for nearly 95 percent. Furthermore, supervision of rural credit operators is insufficient due to NBC's staff being relatively short of capacity and resources to manage growing microfinance activities.

### 6.3. Insurance Sector

Progress has been made in the insurance sector. An inter-ministerial *Prakas* - Ministry of Interior, Ministry of Tourism, Ministry of Public Works and Transport and Ministry of Economy and Finance - was issued in 2002 on three areas of compulsory insurances: (i) compulsory motor vehicles or third party liability insurance; (ii) compulsory insurance of passenger transports; and (iii) compulsory insurance for construction site.<sup>27</sup>

**Table 6.4: Recent Developments in Insurance Sector**

Progress	Remained Issues
<ul style="list-style-type: none"> <li>▪ Promulgated Law on Insurance</li> <li>▪ Established compulsory insurance</li> <li>▪ Four operators: (1) Asia Insurance Ltd.; (2) Forte Insurance (Cambodia) Plc; (3) CAMINCO; (4) International Commercial Insurance Company Plc</li> </ul>	<ul style="list-style-type: none"> <li>▪ Insufficient enforcement of compulsory insurance due to lack of enforcement and monitoring mechanism</li> <li>▪ Weak supervisory and regulatory capacity</li> <li>▪ Lack of public awareness of insurance services</li> </ul>

**Source:** Cambodia Economic Watch (2005), ADB (2002) and MEF, Insurance Division (2005).

This legal framework brings positive effects for the insurance business. As of September 2005, there are companies operating insurance businesses with sector leader Asia Insurance (46%), runner-up Forte Insurance (43%), CAMINCO (11%) and a new entrant, International Commercial Insurance Company. This compulsory insurance also opens

<sup>27</sup> Compulsory Motor Vehicle or Third Party Liability Insurance: all types of commercial motor vehicles caring goods, passengers, and tourists; all types of motor vehicles owned by a company, enterprise or factory; motor vehicles of non-governmental organizations, international organizations and associations; motor propelled or towed cement mixers and construction vehicles; and motor tricycle used for the transport of goods or passengers. Compulsory Insurance of Passenger Transports: all types of passenger transport are required to have passenger transport liability insurance. Compulsory Insurance for Construction Site: all constructions, rehabilitation of existing constructions, and installations that are under the responsibilities of entrepreneurs, contactors or sub-contractors shall purchase construction liability insurance

markets for insurers. Automobile insurance gained US\$1.6 million which took the market share of 17 percent of business underwritten in 2004. Third party liability insurance boosted the miscellaneous class to account for 38 percent of Cambodian insurance markets.

**Table 6.5: Cambodia: Gross Premium Written  
by Line of Business, 2004**

<b>Line of Business</b>	<b>Gross Premium (US\$)</b>	<b>Share</b>
Auto	1,526,621	17%
Fire	2,412,011	27%
Marine	325,685	4%
Engineering	180,222	2%
Workman Compensation (WC)	53,015	1%
Personal Accident (PA)	511,577	6%
Health and Surgical (H&S)	427,008	5%
Miscellaneous	3,437,722	39%
<b>Total</b>	<b>8,873,870</b>	<b>100%</b>

**Source:** *Asia Insurance Review (2005)*.

Despite these improvements in regulatory frameworks, enforcement of the inter-ministerial *Prakas* of compulsory insurance is not so strong due to insufficient enforcement and monitoring mechanisms and resources. The insurance division of MEF is young; the understanding of the insurance business of relevant ministries is lacking; and government law enforcement efforts have been undermined by insufficient financial resources and incentives.

## Chapter 7

### Public Financial Management Reforms

In its efforts to transform the public financial system into a pro-poor fiscal policy<sup>28</sup>, the government of Cambodia has produced a “Public Financial Management Program: Strengthening Governance Through Enhanced Public Financial Management” and claimed full ownership of designing and implementing the reform process.

The document is used as a vision and guide for a comprehensive and systematic public financial reform program till 2015, aiming at upholding higher standards of management and accountability in the government resources mobilization and their effective and efficient utilization.

There are four platforms in the reform program: (i) A more credible budget; (ii) Effective financial accountability; (iii) The RGC policy agenda becomes fully affordable and prioritized; and (iv) RGC managers become fully accountable for program performance. At last year’s consultative group meeting (CG), the government pledged to implement the first of its four stages in its reform program to achieve platform one which is to make the budget more credible. There are 33 priority activities covering more than 200 actions to be implemented from 2004 to 2006 (15 to 20 months).

Even though concrete results from reforms are not obvious in the short-run, some of them can be observed through whether the government continues to make some improvements, for instance, in tax and non-tax collection, management of public expenditure and other national assets. Some of these are short-term and spontaneously achievable, should political will exist. However, systematic and long-term reforms are fundamental for sound and sustainable public financial management.

#### 7.1. Revenue Mobilization through Customs and Taxation Reforms

The real achievements are reflected through indicators such as growths in revenue mobilization and more result-oriented expenditures. Data from MEF suggests that there have been gradual improvements in tax collection due to the reforms. An average tax revenue, the main component

---

<sup>28</sup> Higher salary for majority of public servants, better public service deliveries and other pro-poor tax rates on basic consumptions that have immediate impacts on living conditions of the poor, such as tax-induced higher prices of petroleum that cause negative multi-effects on the whole economy.

of revenues, increased by more than 10 percent annually during 2001 – 2004. Non-tax revenue also improved at the same period but is still low.

The implementation of reforms in the first six months of 2005 seems to yield some progress such as restructuring of MEF (establishment of new department such as department of non-tax revenue<sup>29</sup> and other departments), an establishment of inter-departmental working groups, procedures for recruitment of qualified and experienced officials, and providing merit-based remuneration for 250 staff to implement the reforms.

As presented in section 4 on fiscal development, revenue collection for the first six months of 2005 increased by 22 percent compared to the same period of 2004. The increase stemmed from the continuous strengthening of the tax and custom administration. Tax compliance was improved due to simplified procedures and time-saving for tax payers, improvement in tax collection from large and medium tax payers (real regime), and strict tax auditing and collection of tax areas.

If the trend remains robust till the end of 2005, total revenue may reach more than 11 percent of GDP, the same as its peak level in 2001. But the total revenue is still below the targeted share of GDP and revenue potentials and is unlikely to reach 14 percent in 2005 as stated in the National Poverty Reduction Strategy (2003 – 2005).

However, revenue from trade taxes and non-tax sources, even though improved, are still a big concern. While most collections from import duties and excises increased, the revenue from petroleum decreased by about 49 percent in the first half of 2005 compared with the same period of 2004. Smuggling of petroleum is still at large as its consumption which is unlikely to decrease. Imports of petroleum-dependent goods such vehicles continue to increase significantly. For the first half of 2005, the import of cars increased by 158 percent, buses 99, trucks 31 and tractors 43 percent compared with the same period of 2004.

Non-tax revenue is still small and revenue collection from unused lands and other state properties are very low. Moreover, most concessions on fee collection activities (such as fees to enter Angkor Wat complex) are awarded to private companies without the appropriate bidding. Likewise, most exchanges of state fixed assets and concessions are done without the knowledge of MEF. The exchanges (swaps) are mostly approved by the Council of Ministers and MEF is just playing an accommodating role rather

---

<sup>29</sup> Ministry of Economy and Finance, Prakas No.236 dated 12/05/2005

than a leading role in the management of state fixed assets<sup>30</sup>. There is no concrete report on gains to national revenues from these exchanges.

The incomes from these areas could be improved significantly if existing regulations (tax law, combating smuggling and tax evasion, open bidding for all concessions, and management of state assets) are simply and duly implemented on a daily basis, while aiming to achieving goals in a long-term reform program.

## 7.2. Public Expenditure Reforms

In its reform agenda, the government is determined to “streamline expenditure” and move forward result-oriented budgeting in order to meet its strategies and priorities, especially poverty reduction and meeting its Millennium Development Goals. The improvement in revenue mobilization would have provided adequate funds for provision of salary and public service deliveries.

The government has long been committed to increase budgetary disbursements to four priority ministries to 3.6 percent of GDP by the end of 2002. In fact, priority sector expenditure has steadily increased from only 1.5 percent of GDP in 1998 to around 3.3 percent of GDP in 2002, but the ratio has kept declining since then, to 2.9 percent in 2004. In contradiction, spending on other civil ministries increased significantly at the same period.

Slower progress in management of expenditures, especially on priorities, reveals some bottlenecks in streamlining payment and executions of the budget to ensure a predictable and timely disbursement of funds needed for improving public service deliveries<sup>31</sup>. Even though Medium Term Expenditure Framework (MTEF) has been introduced since 2002 along with the Priority Action Plan (PAP) to link public expenditure to long term development program, the intended performance-based budgeting has not been introduced.

The public financial management information system is under improvement to speed up budget preparation and implementation, and to capture revenues, real costing, and result-oriented expenditures. But lack of capacity and low morale of officials to undertake systematic reforms across

---

<sup>30</sup> Ministry of Economy and Finance. Prakas No. 386 dated 20/10/2004. Procedures in Exchange of State Fixed Assets for Ministries, Institutions, Cities and Provinces.

<sup>31</sup> It is important to note that 60 percent of the landless caused by land sold to cover costs of health care, according to GTZ and Oxfam (PSIA): “Poverty and Social Impact Assessment of Social Land Concession in Cambodia: Landlessness Assessment.” 29 February 2004. p. 5. Insufficient public health care continues to threaten likelihood of the poor.

ministries are also grave challenges<sup>32</sup>. Moreover, weak enforcement of public procurement procedures, absence of stricter financial and performance auditing are loopholes in wastages of public funds.

The government is again committed to address these remaining issues by implementing its reform vision. Even though MEF is playing a leading role, the success of the whole reform program depends on commitments, genuine efforts, and performances of all governmental institutions. The first step to realize the vision is to adhere to an annual budget law and existing expenditure principles such as open-bidding for all public procurements. Speedy and timely disbursements for priority ministries are crucial to mitigate the financial burden of the poor who are dependent on public services, especially health care.

---

<sup>32</sup> EIC's consultations with stakeholders.

## Chapter 8

### Trade Reforms

#### 8.1. Economic Integration

Progress in enacting laws which conform to WTO accession in 2005 is at a very slow pace. Since it resumed working after the political impasse last year, the National Assembly has approved only two pieces of WTO conformity legislation, Law on Business Enterprise (May 2005) and Law on Negotiable Instruments and Payment Transfers (September 2005). Another remaining 30 pieces of law have been in draft forms. And, these draft acts have been back and forth within government ministries and/or between government and the Parliament for comments and to make some changes.

Delays of these law enactments, from drafting to promulgation, were partly due to a shortage of financial and technical resources and capacity, lack of coordination among government ministries and insufficient parliamentary sessions. Thus, prospects for adoption of 28 laws to meet their specific deadlines, 2005-2006, are getting more and more difficult. It is likely that four pieces of legislation- Civil Code, Civil Procedure Code, Criminal Code, and Civil Procedure Code – will be enacted by 2006 as the government puts them in the top priority law adoption agenda.<sup>33</sup>

**Table 8.1: Status of Progress of Enacting Laws for WTO Conformity, as of May 2005**

	Relevant Agency	2005	2006	2007	Status of Progress
<b>Judicial Reform</b>					
1. Law Establishing the Commercial Court	MoC	Expected			Being reviewed at MoC as of May, 12 2005. Expected to send to NA by June 2005
2. Commercial Arbitration Law	MoC	Expected			Draft Law sent to NA
3. Civil Code	MoJ	Expected			Draft. Currently being discuss at Council of Jurists

<sup>33</sup> See in the section of legal reforms, in addition to these four pieces of laws the government has given priorities to other four: (1) anti-corruption law; (2) organization and functioning of the courts; (3) the amendment of the Supreme Council of Magistracy; and (4) the status of judges and prosecutors.

	<b>Relevant Agency</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>Status of Progress</b>
4. Civil Procedure Code	MoJ	Expected			Draft. Completed the discussion with the Council of Jurists. Awaiting inter-ministerial meeting.
5. Criminal Code	MoJ		Expected		Draft. The Council of Jurists has no objection on current draft.
6. Criminal Procedure Code	MoJ		Expected		Currently being revised with France's collaboration to be coherent with the draft Civil Procedural Code.
<b>Trade-Related</b>					
7. Law on Geographical Indications Including Appellation of Origin	IPs CC	Expected			Draft law is being discussed at the ministerial level. Expected to be complete at the end of 2005.
8. Laws on Layout Design of Integrated Circuit	IPs CC		Expected		Draft law needed TA. Expected to be complete at the end of 2006.
9. Laws on Plant Variety Protection	IPs CC		Expected		Draft law needed TA. Expected to be complete at the end of 2007.
10. Law on Protection of Undisclosed Information	IPs CC		Expected		Unidentifiable
<b>Custom Valuation</b>					
11. Custom Code		Expected			Draft Law
12. Law on Rule of Origin	MoC & MEF	Expected			Working on draft law
13. Law on Anti-dumping Measures and on Countervailing Measures	MoC		Expected		Draft law
<b>Trade-Related Investment Measures (TRIM)</b>					
14. Law on Export Processing Zones	MoC	Expected			Draft law with CDC & MIME on EPZ. A meeting held at CDC to prepare Sub-Degree on SEZ

	<b>Relevant Agency</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>Status of Progress</b>
<b>Financial Intermediation</b>					
15. Insolvency Law	MoC	Expected			Draft law : pending debate at inter-ministerial meeting at the OCM 1st quarter 2005
16. Secured Transaction Law	MoC	Expected			Draft law : pending debate at inter-ministerial meeting at the OCM 1st quarter 2005
17. Securities and Exchange Law				Expected	Unidentifiable
18. Commercial Leasing Law	MoC		Expected		Being drafted by NBC
<b>Other Areas</b>					
19. Water Supply Law		Expected			Draft law
20. Water Resources Management Law		Expected			
21. Telecommunication Law	MPTC	Expected			Draft Law on Telecom is being reviewed within the MPTC and plan to submit to CMs in September 2005.
22. Tourism and Entertainment Law	MoT	Expected			Draft law was withdrawn from NA & being reviewed by MoT. Expected submission to CMs in June 2005.
23. Civil Aviation Law	SSCA	Expected			Pass Civil Aviation Law and draft implementing regulations
24. Merchant Shipping Law			Expected		
25. Land Traffic Law (Highway Code)	MPWT	Expected			Draft law

	Relevant Agency	2005	2006	2007	Status of Progress
26. Fisheries Law	MAFF	Expected			Draft law was sent back from NA & re-debated at COM to reflect issue of decentralization.
27. Commercial Contracts Law	MoC	Expected			Draft: expected to be passed in 2006
28. Commercial Agency Law	MoC		Expected		Draft is completed by MoC
29. Competition Law	MoC			Expected	Draft law in the process of interviewing & collecting information
30. Law on Safeguard Measures			Expected		

**Sources:** *Reproduced based on IMF (2004b), Table 1 in Chapter 6 & MoC (2005a).*

## 8.2. Trade Facilitations

In the area of trade facilitation and investment climate, progress of implementation of the twelve point plan has been made. Half of the twelve action plans have been carried out: (i) established a cross-agency trade facilitation and investment climate reform team; (ii) established a system of transparent performance measurement; (iii) reviewed role of Camcontrol; (iv) streamlined process and reduced cost of commercial registration; (v) implemented a national award to promote good corporate citizenship in the private sector; and (vi) implemented monitoring and reporting through private sector forum. The rest of the plans are expected to be completed by December 2005 (WB, 2005 & MoC 2005b).

After a series of reviews, the future of Cambodia Import Export Inspection and Fraud Repression Department of the Ministry of Commerce (CamControl) – which has some redundant roles with the Customs and Excise Department - will have some or all of its structures integrated into the Customs Excise Department of the Ministry of Economy or the Ministry of Industry, Mines and Energy or the Ministry of Agriculture, Fisheries and Forestry or the Ministry of Health or it will be established as a new agency called “Food and Safety Cambodia”.

**Table 8.2: Twelve point plan: Government Commitments to Improve the Investment Climate and Trade Facilitation**

Twelve point plan	Status	Outcome
1. Establish a Cross-Agency Trade Facilitation /Investment Climate Reform Team	Done	
2. Establish A System of Transparent Performance Measurement including Private Sector Monitoring	Done	
3. The trade facilitation process, including all licenses, procedures and documents, will be reviewed to remove overlaps and unnecessary approvals. Following the reengineering, a single administrative document will be implemented and other documents progressively eliminated.	Progress	
4. Introduce an overall risk management strategy to consolidate and rationalize all examination requirements of the different	Progress	
5. A strategic review of the role of CamControl will be launched to more productively deploy the organization's unique knowledge of quality control processes and make optimized use of inputs and resources from other agencies, such as the CED.	Done	Two options restructuring of CamControl: (i) merging some or all of CamControl's functions with Customs, MIME, MAFF or MoH; (ii) creating a new food and drug agency with a working
6. A Single Window process to manage trade facilitation will be piloted in the Port of Sihanoukville by December 2005. The Trade Facilitation process, once streamlined, will be automated by December 2005.	Progress	
7. The Government will introduce a WTO compatible flat fee for service, and the service will be defined by a service-level agreement. The fee structure will be public.	Progress	▪
8. Streamline the process and reduce the cost of incorporating with the Commercial Register, which is maintained at the Office of the Clerk of the Commercial Court, and costs an average of \$630 and 30days.	Done	<ul style="list-style-type: none"> <li>▪ Business Registration cost has been reduced by over US\$400</li> <li>▪ Minimum deposit requirement has been reduced from US\$5,000 to US\$1,000</li> </ul>
9. Streamline the process notification of the Ministry of Labor to start hiring employees, which costs \$250 and 30 days to complete.	Progress	
10. Harmonize registration for VAT, income tax and company registration using the same form and resulting in the same number. This would enable a unique identifier and facilitate information sharing across agencies.	Progress	
11. Streamline the process notification of the Ministry of Labor to start hiring employees, which costs \$250 and 30 days to complete.	Progress	

<b>Twelve point plan</b>	<b>Status</b>	<b>Outcome</b>
12.Streamline the process notification of the Ministry of Labor to start hiring employees, which costs \$250 and 30 days to complete.	Progress	
13.Harmonize registration for VAT, income tax and	Progress	
14.Implement a national award to promote good corporate citizenship and governance in the private sector.	Done	(1) Hotel Cambodiana; (2) Conferel Co, Ltd.; (3) New Island Clothing (Cambodia) Ltd; and (4) Hagar Soya.
15.Monitoring and Reporting	Done	

**Sources:** *World Bank (2005), MoC (2005a), Personal Communication with MPDF and Secretariat of Government-Donor Coordination Committee (2005).*

Another recent effort in trade reforms is the preparation of the National Export Strategy (NES) intended to reap potential benefits from market access of world trading systems and regional cooperation. NES primarily prioritizes six areas of export development and promotion (1) Garments (2) Fruits and Vegetables (3) Inland Fisheries (4) Organic Rice (5) Silk and Silk Products and (6) Tourism. This national strategy paper is scheduled to be adopted by the Council of Ministers at the end of 2005. Yet, to get actual benefits from this national strategy will depend largely on other structural reforms, in particularly reforms to improve the business environment and trading activities.

## **Chapter 9**

### **Public Administrative Reforms**

A decent salary and capable human resources are the only way to promote effectiveness of public service delivery. They are also the grassroots of other public administration reforms. Passing distinct phases, the 7<sup>th</sup> CG meeting's commitments of civil administrative reform seem focused more on these two issues but results are questionable.

Decentralization and deconcentration, on the other hand, are also on a tough agenda of preparing a legal framework, action plan and legislations which allow sub-national government and commune councils to obtain more responsibilities and duties, to be more powerful and autonomous even in terms of revenue collection.

This part presents the achievements and remaining issues of public administrative reform so far. It also reviews the progress of the government's commitments during the 7<sup>th</sup> CG meeting and is ended by an analysis of impacts and some critical challenges.

#### **9.1. Civil Administrative Reforms**

It is noted that there is progress on pay reform. The average basic salary and allowance has been increased by 44 percent in mid 2002 which resulted just from a civil census and better control of the work force database.

In January 2005, the government increased the index value by 15 percent from 300 Riel to 345 Riel as a stipulated commitment of the Rectangular Strategy. The index value is a tool to define civil servants' basic salaries and civil servants have index numbers which range from 100, at minimum in category D, to 550 at maximum in category A. Furthermore, in August 2005 the government increased functional allowances of staff in middle and senior administration and priority sectors (Education and Health).

In 2005, a number of training courses and seminar awareness were conducted aiming at capacity building. The first promotion of management development program (MDP) and professional development program (PDP) which are parts of the Economic and Public Sector Capacity Building Project (EPSCB) were recently completed.

Both programs trained 155 staff from various institutions countrywide in the area of management and professional development

including development policy, governance and applied economic development.

The priority mission group (PMG) program, scheduled to be implemented since the end of 2002, has seen some progress compared to the last six months. CAR received proposals from 14 ministries among 28 ministries and agreed with 10 ministries to recruit their staff to join PMG group since May 2005. However, there are only two ministries, Ministry of Health and Ministry of Women Affairs, which sent their list of participants to CAR for auditing and approval.<sup>34</sup> The government prospers that PMG program can be implemented within 14 ministries by the end of this year, which means that it would reach 50 percent of its plan.

Benchmarks promised in the 7<sup>th</sup> CG meeting in 2004, most of them scheduled to be completed by the end of 2005, are seeing progress. As a pilot, CAR and Ministry of Economic and Finance (MEF) have agreed to establish the PMG/MBPI (Merit-Based Pay Initiative) to cover an initial 300 centrally located civil servants working on high priority PFM reform activities. The CAR and treasury also reached an agreement on the use of the private banking system to reduce cash transactions in the payment of salaries.

However, the commitment on a strategy to phase out donor-salary supplement and to redirect them in support of pay reforms in priority areas, committed by June 2005, was not met. There is requisite technical assistance to further the strategy and further need of consultation with sectoral technical working groups (TWGs).

Even though these achievements are impressive, public service delivery could not serve people much better. The salary increase for civil servants is still not adequate. Functional allowances increases only benefit marginally those in middle and senior management, which are already better off, and two priority sectors. A large number of civil servants are suffering from low salaries, which forces them to become involved in corruption and inefficient service delivery.

---

<sup>34</sup> This figure is as of September 16, 2005.

**Table 9.1: Recent Developments in Public Administrative Reform**

<b>Civil Reforms</b>	
<b>Progress</b>	<b>Remained Issues</b>
<ul style="list-style-type: none"> <li>▪ NPAR phase I was completed. The key accomplishments include census and removal of irregulars, computerized personnel management and payroll system, and pay, employment and fiscal balance simulation.</li> <li>▪ Implementation of new remuneration and classification system.</li> <li>▪ In early 2005, government increased civil servant salaries by changing the index value from 300 CR up to 345 CR. In August 2005, the government increased functional allowances for middle and senior administration and priority sectors.</li> <li>▪ The MOU of PMG/MBPI was signed between CAR and MEF for PFM reform program.</li> <li>▪ Agreement reached between treasury and CAR on use of private banking system to reduce cash transactions in the payment of salary.</li> <li>▪ Ministry of Health and Ministry of Women Affaire sent list of staff to join PMG to CAR for auditing and approval.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Failure to complete a set of studies to make civil service reform plan consistent with Medium Term Expenditure Framework. The medium term civil service pay is underdeveloped.</li> <li>▪ By schedule, failure to recruit 1,000 PMG members by the end 2002. In 2005, 1,205 PMG members and budget of US\$ 1.5 million are planned to implement. Most of ministries have not sent yet their lists of staff to join PMG, even their proposals.</li> <li>▪ Code of Ethic has not been approved yet.</li> <li>▪ Agreement between government and donor on a strategy to phase out donor funded salary supplement and redirect them in support of pay reforms in priority areas by June 2005.</li> </ul>
<b>Military Reforms</b>	
<b>Progress</b>	<b>Remained Issues</b>
<ul style="list-style-type: none"> <li>▪ Pilot program of 1,500 soldiers were mobilized in 2000. 15,000 ex-combatants were demobilized in late 2001.</li> <li>▪ In January 2005, government completed two conditions namely repayment of US\$ 2.8 million and submission of financial report management.</li> <li>▪ Third condition of project's audit report was completed in May 2005.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Second phase of demobilization was suspended in 2003 due to irregular procurements related to compensation packages.</li> <li>▪ Recently, the government expressed its willing to find fund support to demobilize excessive number of armed force.</li> </ul>

**Source:** EIC, compiled from various government sources, interview and intentional NGOs, September 2005.

Besides technical problems with proposals which cause the delay of implementation, PMG is suffering from the ignorance of senior

government in the relevant ministries. One might say that PMG programs do not give any individual interest. Furthermore, the salaries for PMG staff will be lower than salaries planned before. They will get only US\$130, US\$87.5 and US\$47.5 for category A, B and C respectively; while they had planned US\$150, US\$100 and US\$50 in 2002 for those respective categories.<sup>35</sup>

## 9.2. Military Reforms

The government has committed to military demobilization and embarked on a three-year plan to demobilize a total of 31,500 soldiers from the Royal Cambodian Armed Forces (RCAF). In 1999, the government removed 15,551 irregular soldiers from the payroll which resulted just from registration and data collection.

In four provinces, 1,500 soldiers were demobilized as a pilot project in 2000. In late 2001, the government implemented full-scale demobilization throughout the country and another 15,000 ex-combatants were demobilized. As an incentive, demobilized soldiers received a reintegration package when leaving the armed forces.

The demobilization was suspended in 2003 and its second phase, a group of 15,000 which was scheduled by the end of 2002, was never met. This was due to evidence of irregular procurement related to the compensation package, which was found by the World Bank.

Three conditions were put to the government: namely, the repayment of US\$2.8 million, the submission of a financial management report and the submission of the project's audit report. In January 2005, the government decided to repay the Bank US\$2.8 million related to a misprocured contract for motorbikes and the financial management report was also submitted. In May 2005, the government completed one third of the project's audit report.<sup>36</sup>

Obviously, the government's commitment in the Rectangular Strategy to continue armed force reform and demobilization has not seen any progress. However, the government recently expressed at the National Assembly that it is seeking funding support to demobilize the excessive numbers of armed forces and warns of a number of current ghost soldiers on the payroll.

---

<sup>35</sup> With exchange rate: \$1=4,000 Riels

<sup>36</sup> Based on interview with government official, September 15, 2005.

### 9.3. Decentralization and Deconcentration Reforms

Decentralization and Deconcentration (D&D) is a way to place the government close to the people to better understand the needs, preferences and priorities of each specific location. The government has agreed that D&D contribute to transparency, local participation, cost reduction and quality of projects, and sustainability.

Decentralization has seen some progress. The law on administration and management of communes and sangkats (LAMC) and the commune election law were adopted in 2001. The first commune elections were held in 2002 and 1,621 commune councils were elected. They have their own funds, so-called “Commune/Sangkat Fund (CSF)” to manage administrative costs and development.

The capacity of commune councils has been strengthened through training programs and, as a result, they are able to prepare five-year development plans, three-year rolling investment plans and an annual budget.

**Table 9.2: Recent Developments in Decentralization and Deconcentration**

Decentralization & Deconcentration	
Progress	Remained Issues
<ul style="list-style-type: none"> <li>▪ Enacting Law on Administration and Management of Commune (LAMC) and Commune Election Law. Commune election was held in 2002.</li> <li>▪ Training program to enhance capacity of commune councils. Commune councils are able to prepare five-year development plan, three-year rolling investment plan and annual budget.</li> <li>▪ Commune councils has own funds to manage local affairs.</li> <li>▪ A pilot of One-Window Service (OWS) was created in Srok Battambang and Srok Siemreap.</li> <li>▪ D&amp;D National Strategic Framework was approved by Council of Ministers on 17 June 2005.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Process of fiscal decentralization is slow and commune councils do not have yet authority to collect local taxes.</li> <li>▪ A number of rules and regulations as mandated by LAMC are not passed yet in support of decentralization reforms.</li> <li>▪ Few service delivery functions are devolved to commune councils and most public services are under control of provincial line ministries.</li> <li>▪ Organic law on provincial and district government has not been passed yet.</li> <li>▪ No action plan prepared to implement D&amp;D strategic framework.</li> </ul>

**Source:** EIC, compiled from various government sources, interviews and intentional NGOs, September 2005.

The government also recognizes the capability and effectiveness of commune councils to some extent. Projects undertaken by commune councils obtained 20 percent of cost reduction and better quality than ones undertaken by central government such as ministries or provincial departments.<sup>37</sup> This is due to the transparency of project procurements which reduce rent-seeking fees.

Also, it clearly demonstrated its commitment to increase commune council revenues. It increased its contribution to CSF from 1.5 percent of current revenue in 2002 to 2 percent and 2.5 percent in 2003 and 2004 respectively. The government committed to increase this percentage from 2005-2007 by 0.02 percent per annum.

Nevertheless, there has been little progress on the deconcentration side. Ministries have issued a number of decisions to devolve certain powers to lower levels. A pilot of one-window service (OWS); which offers a one-stop-service for facilitating access, efficiency and transparency; was created in Srok Battambang and Srok Siem Reap. The government is preparing to include the staff of these two districts into PMG.

During the 7<sup>th</sup> CG meeting in December 2004, the government committed to two achievements namely the national strategic framework on D&D; and the first draft of the D&D organic law on the management of provincial & district, municipalities and capitals. The D&D strategic framework was approved by the Council of Ministers on 17 June 2005, but there is no action plan yet to implement this strategic framework. This causes difficulties for donors to allocate their support funds. On the other hand, the government has just established an inter-ministerial committee to formulate an organic law on the sub-national governance system.

Furthermore, the commune councils have not yet been delegated official duties and have few services to serve people while most public services are under the control of ministerial and provincial lines.

Likewise, there is no clear guideline policy for deconcentration and its process seems to rely heavily on the commitments of line ministries which are reluctant to delegate responsibility and decision-making to provincial and district administration.

Commune councils have limited funds which result in a low level of services and investment implementations. Currently, they get funds from government, which experienced a cash shortage in 2003, and a small contribution from local people. The fiscal decentralization, which is defined in LAMC to give authority to commune council to levy and collect

---

<sup>37</sup> Based on interview with senior government official, September 16, 2005.

local taxes, seems unforeseeable. This is due to several reasons including double taxation, weak capacity at all levels and the government's unwillingness to act.

It is a must to speed up the putting in place of an action plan to implement the national D&D strategic framework. This strategic framework is the basic policy for the sub-national governance system. It enables to establish any regulations delegating duties and responsibilities at a sub-national government.



## **Chapter 10**

### **Legal and Judicial Reforms to Improve Governance**

In the Cambodian context where “the rule of law” has been set as the country’s basis, legal and judicial reforms appear to be fundamental to the reestablishment of the country toward a real democratic and free-market economy regime. A “credible, predictable and transparent legal framework” together with “an independent and capable judiciary” will help the Cambodian democracy-based government to successfully achieve its other reform agendas in the right direction for poverty reduction and sustainable economic growth.

In these reform areas, critical issues remain to be tackled and more efforts need to be made though some positive results have been achieved.

#### **10.1. Legal Reforms**

In the legal reform process, the government has made notable progress in the area of reform policy and strategy. In mid-2002, a specialized Council for Legal and Judicial Reform (CLJR) was established to initiate, encourage and coordinate the reform process. In June 2003, the legal and judicial strategy was completed and followed by a draft action plan of July 2003, the official paper of which was recently adopted in April 2005. Through priorities and timelines provided in these instructive instruments, some positive results have been achieved over recent years (See box 10.1 for recent development). Importantly, all laws and regulations are regularly published in the official gazette and public procurement is competitively bid for by all ministries except the Ministry of Royal Palace.

In terms of regional and global integration, the Parliament has ratified and adopted 16 out of 47 laws and regulations for compliance with WTO regulations, and signed a number of agreements within the ASEAN framework. Presently, further trade-related laws are submitted for adoption before the National Assembly such as the law on commercial arbitration, the amendment of the law for the chamber of commerce, etc.

Despite this partial progress, the achievement made is generally marked by a relative tardiness and leaves some critical actions to repeatedly remain within the reform agenda if compared to what has been promised. This is the reason why priority for the period of 2005-2006 is currently given to the adoption of eight draft laws, most of which are the long unmet commitment of the government since the Tokyo CG meeting in 2001.

These texts include four drafts of basic codes in the civil and criminal areas, the anti-corruption draft law and three judiciary-related draft laws, pertaining to the organization and functioning of the courts, the amendment of the Supreme Council of Magistracy, and the status of judges and prosecutors.

In the area of the fundamental legal framework, only the civil procedure draft law is, up to mid-September 2005, reported to have been sent to the National Assembly while the penal procedure is left for more discussion within the Council of Ministers, and the other two within the line ministry. The failure to adopt these basic codes on time derives from the underestimation of timeframe on account of their complexity and dimension and the necessity of making them all coherent, especially while the drafting of these codes was originally entrusted to different foreign legal experts.

Nonetheless, much concern is expressed over the adoption of the anti-corruption law since it has been criticised as not yet compliant with international standards and international good practices and a number of terminologies used therein are subject to further reviews<sup>38</sup>. During a launching workshop on “Cambodia’s Draft Law on Anti-Corruption and International Standards” organised in mid-August 2005, concerns were focused over the method of asset declarations and principally over the independence of the future anti-corruption body.

Particularly raised during the workshop, it was suggested to include a representative from civil society within the structure of the future Supreme National Council for Anti-Corruption (SNCAC) and having advisory committees of members of the public within each anti-corruption body, to provide a more diversified mix of people. It was also recommended that the council’s investigators should not be placed under the authority of the court prosecutor for search and seizures as this would restrain their independence.

---

<sup>38</sup> As observed within a launching workshop on ‘*Anti-Corruption Law and International Standards*’, organized by the Ministry of National Assembly and Senate Relation and Inspection, 17-18 August 2005 and Cambodia Daily ‘*Criticisms of Anti-Corruption Law Discussed*’, 19 August 2005

**Table 10.1: Legal and Judicial Reforms**

<b>Legal Reform</b>	
<b>Progress</b>	<b>Remained Issues</b>
<ul style="list-style-type: none"> <li>▪ Council of legal and judicial reform was established to coordinate reform efforts. In mid-2003, legal and judicial strategy was completed, followed by a draft action plan thereof; the official action plan for implementing the legal and judicial reform strategy was adopted in April 2005.</li> <li>▪ Public procurement is competitively bid for all ministries except for the Royal Palace.</li> <li>▪ The National Assembly ratified and adopted sixteen laws and regulations for compliance with WTO regulations, the most recent of which are the law on business enterprises and negotiable and payment transaction law.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Failure to adopt anti-corruption law. It is long unmet pledge sine Tokyo CG meeting in 2001.</li> <li>▪ Fundamental legal framework such as civil code, code of civil procedures, penal code and code of penal procedures has not submitted yet to the National Assembly.</li> <li>▪ Thirty one laws and regulations need to be ratified and adopted for compliance with WTO regulation.</li> </ul>
<b>Judicial Reform</b>	
<b>Progress</b>	<b>Remained Issues</b>
<ul style="list-style-type: none"> <li>▪ Establishment of Professional Training Centre for Lawyers and Royal School of Magistracy (RSM).</li> <li>▪ Separation of budget of judiciary from that of Ministry of Justice.</li> <li>▪ Recently emergency campaign “Iron Fist” to strengthen judicial integrity.</li> <li>▪ Removal of the Secretariat of the Supreme Council of Magistracy by Sub-decree dated May 05, 2005.</li> </ul>	<ul style="list-style-type: none"> <li>▪ The law on the statute of judges and prosecutors has not been submitted yet to the National Assembly.</li> <li>▪ The law on the Organization and Functioning of Supreme Council of Magistracy (SCM) has not passed; hence the SCM has not been restructured.</li> <li>▪ No specialized court has been established and the municipal and provincial courts still overlap concerning dispute resolution in most areas.</li> </ul>

**Source:** EIC, compiled from various government sources, IMF, World Bank, and interviews.

On all of these issues, discussion was mainly focused on whether the draft anti-corruption law is compliant enough with the international standards and good practices while the issues of whether the law would be realistically appropriate to the Cambodian corrupt practices seemed to be

modest. Rightfully based on international standards and good practices, the government together with donor countries would profitably need to do more impact studies within the law-making process in order to let those good practices fit well with the Cambodian environment.

Though a great delay has already been made in the drafting process of this anti-corruption law, the final text should not be the result of rushed work. Focus should continue to improve the independence of the SNCAC from other political powers and, once this anti-corruption body is independently empowered, legal obligations of those who exercise this autonomous function need to be firmly and clearly set up to help the judiciary to transparently intervene when abuse of power takes place.

In the above context, the independence of the SNCAC deals closely to that of the judicial power. However, the three basic draft laws relative to the functioning and organisation of the judicial system have not yet been in the hands of the Council of Ministers. The failure to adopt these legal texts on time does not reflect tardiness in the legal reform process alone but especially the reform in the judiciary area since these laws appear to be quite fundamental to the early stage of the judicial reform process.

In the legal process as a whole, it is particularly noted that there was a delay due to the recent political deadlock and a lack of political will, technical competency and financial assistance. The consultation within and between ministries takes a relatively longer time and each individual ministry tends to protect its own interests<sup>39</sup>. A broad picture of the reform process showed that progress had been notably slow where conflict of interests between state institutions exists. Up to the present however, no law on a specialized court, the drafting of which generally needs the participation from the Ministry of Justice and other specialized ministries involved, has been passed while the adoption of other WTO-related laws and regulations have seen considerable progress.

Furthermore, the absence of an official guideline clearly determining procedures at every stage of the law-making process presents a big constraint on the progression of legal reform. Despite the fact that the significance of public consultation in the law-making area is repeatedly recognized by the government's strategic policy, this necessity has not yet been officially incorporated within any positive rules. As revealed by the CLJR however, a kind of guideline for legal act-making process is being prepared by the government with the intention to ensure participation and transparency. It would be beneficial if a participatory stage is provided within the guideline preparation process before its enactment.

---

<sup>39</sup> Economic Institute of Cambodia (EIC) 2005. *Cambodia Economic Watch, April 2005*, p. 75

Concrete action should be appropriately taken in accordance with what has been scheduled, especially relating to the eight foremost priorities of the current reform agenda. Without the passing of these basic legal instruments, other reform agendas, principally the judicial, would inevitably meet obstacles.

## **10.2. Judicial Reforms and Law Enforcement**

Over recent years, some improvement has been made in the judicial infrastructure. The Professional Training Centre for Lawyers and the Royal School of Magistracy (RSM) were established and a pilot court in Kandal province was set up in order to introduce better practices in handling cases and upgrading the court. These would provide highly competent and professional magistrates and lawyers, and thereby strengthen the judiciary system. However, the transparent selection and recruitment of students are pre-requisites for this achievement.

The integrity of the judiciary is being enhanced. In 2003, the government started separating the budget of the judiciary from that of the Ministry of Justice; this presents a remarkable step towards a genuine separation of power. However, deficiency in the legal framework together with slowness of the legal reform in the judicial area unavoidably leaves the government to directly intervene in the judicial reform process.

With an emergency campaign called “Iron Fist”, the government vows to re-arrest armed robbers who are not in prison as a result of bribery, and to arrest corrupt judges and prosecutors. The Ministry of Justice has just created a committee for investigating cases of convicts who remain out of jail, judges and prosecutors. Recently in July 2005, the Supreme Council of Magistracy (SCM) imposed sanctions on a number of judges and prosecutors involved, some of whom were to be removed from duty. It should be particularly noted that the Secretariat of the SCM was recently removed by the government’s sub-decree dated May 05, 2005.

However, a large part of this improvement may just be occasional measures while the reform of core and supplementary legal instruments relating to the organisation and functioning of the judicial system is currently blocked by the tardiness of the legal reform. In reply to this tardiness, no specialized court has been established so far and the municipal and provincial courts are still overloaded with dispute resolutions in almost all areas. The Supreme Council of Magistracy has not been restructured and thereby key reforms to enhance the judiciary’s integrity have not been met.

At this early stage of reform, priority given in the current legal reform agenda appears to be a pre-condition for real judicial reform to get started. Without an appropriate legislative framework, occasional actions may form a kind of discretionary power and thus restrict the essence of the rule of law. But attentive actions undertaken with full spirit of the rule of law would be, where legally appropriate, very beneficial to this transition period to avoid that the slowness of the legal framework reform.

Once the core legal framework has been completed, actions need to be firmly taken recognizing in particular that corruption and interference from other state powers in the judicial branch are seen as the main obstacle to this law enforcement mechanism.

## **Chapter 11**

### **Land and Natural Resources Management Reforms**

Reforms in land, forest, fishery management are still the most important areas and urgent issues to lay the foundation for poverty reduction and sustainable development. As noted, poverty incidents are closely related to landlessness, inaccessibility of the poor to forest and fishery resources, and above all low productivity growth in the natural-based rural activities. Indeed, the government has declared reform programs and taken some measures to improve governance in these areas. However, the significance of the reforms have to be reviewed so that their drawbacks could be identified for further improvement.

#### **11.1. Land Management Reforms**

Land reform is the hottest issue of government reform programs due to growing concerns over land conflicts and the negative impacts from the unproductive use of lands. Without clear and secure land tenure and inventory, it is impossible to rationalize land distribution and management conducive to economic development and as a means to reduce poverty<sup>40</sup>.

Even though genocide and war were factors causing complicated land management as all land titles were destroyed, emerging issues such as landlessness, land concentration, and land grabbing, and confusion in state land management are contemporary phenomena and need to be addressed. In the past decade, the government has taken measures to resolve these problems. A legal framework and land policy have been established to set out a long-term reform strategy. Both management capacity and dispute settlement mechanisms have been strengthened through which the Ministry of Land Management, Urban Planning, and Construction (MLMUPC) is a leading execution agency to implement strategies on land reforms.

But it is interesting to note that in the early stage of land reforms in 1989, upper ceilings were imposed on the size of land ownership: 2,000 sq. meters for residential land, less than 5 ha for cultivated land and more than 5 ha for land concession. The new land law adopted in 2001 does not clearly limit the size of land ownership, but only limits land concessions to less than 10,000 ha. Without an upper ceiling on the size of land ownership, lack of supporting legal framework to implement the land law

---

<sup>40</sup> The World Bank. Land Management and Administration Project, January 29, 2002. p 3 – 6.

in addition to weak enforcement on taxes on unused lands continue to be reasons leading to high land concentration in the country.

Up to 2004, the government had issued 560,000 land titles through Sporadic Land Registration method and 400,000 parcels of land had been registered through Systematic Land Registration<sup>41</sup>. With more qualified officials and the delegation of power to 11 provinces on land registration, on average about 20,000 land parcels can be registered per month. The government plans to issue 1 million land titles through the systematic registration method by 2007 and to grant lands to at least 10,000 households.

Even though the government seems to have made some progress, many challenges remain ahead. The sub-decree on economic land concession has not been approved and inventory of state lands are not available (Sub-decree on State Land Management is under preparation). Rather than finalizing the long-awaited sub-decree on economic land concessions, the government issued a circulation to advise its relevant authorities to grant lands for investment projects but within a limit of 10,000 ha of the land law<sup>42</sup>.

Information on other economic land concessions has not been disclosed as promised at the Consultative Group meeting last year. Some land concessions with sizes exceeding 10,000 ha are still controversial. Land disputes are on the rise though some have been resolved by the Cadastral Committee and through courts (about 2000 cases have been solved<sup>43</sup>). But the poor are still vulnerable to loose the cases due to a lack of knowledge of the land law and corruption in the court system<sup>44</sup>.

Moreover, the grants of large-scale economic land concessions without appropriate socioeconomic and environmental impact assessment have produced minimal benefits for economic development and poverty reduction. These land concessions are partly the source of conflict and thus should be cancelled.

Inadequate information on inventory of state lands, land classification and demarcations are sources of land grabbing. These have caused difficulties in enforcement of article 18 of the Land Law to control both public and private state lands. The recently adopted sub-decree on the

---

<sup>41</sup> Ministry of Land Management, Urban Planning, and Construction. Report on Achievement during 2000 – 2004 and Prospects, 11 August 2005.

<sup>42</sup> Royal Government of Cambodia. Circulation No. 05 dated 01/07/2005 on Awarding Economic Land Concession for Investment in the framework to implement Order No. 02 dated 13/06/2005 on Strengthening Management of State Assets.

<sup>43</sup> Supreme Council for State Reform (2005). *Draft Governance Action Plan II 2005 – 2008*. p. 29

<sup>44</sup> Interviews with stakeholders.

management of public and private state lands will provide more of a legal framework to control large scale public land grabbing and mismanagement. The government should also take urgent and strict measures to curb land concentration and large-scale idle lands by imposing high tax and selectively re-introducing the upper ceiling on the size of private land ownerships.

## 11.2. Forestry Management Reforms

At the Consultative Group meeting last December, the government promised to maintain the suspension/moratorium on logging and transport of logs, except those which have already been inventoried and reviewed. A National Forest Management Plan and National Community Forest Program are scheduled to be established and be implemented in 2005, including the demarcation of forests and protected areas. Forest crime monitoring is continued and other complementary measures such as research and capacity-building of Forestry Administration (FA) are also underway.

**Table 11.1: Recent Developments in Forestry Reforms**

Progress	Remained Issues
<ul style="list-style-type: none"> <li>▪ Public disclosure of existing forest concessions.</li> <li>▪ Strengthening capacity of FA's local officials and to support newly established forest communities.</li> <li>▪ Establishment of community forest management (274) and forest protected areas.</li> <li>▪ Sub-decree No. 53 on Establishment, Classification, and Registration of Permanent Forest Estates, dated 01/04/2005.</li> <li>▪ Decision No. 28 on an Establishment of Control and Evaluation Committee to Stop Encroachment on Inundated Sea Forests, Land Leveling and Land Filling Along Sea Side, dated 14/08/2005</li> </ul>	<ul style="list-style-type: none"> <li>▪ Lack of financial resources and coordination among governmental institution to combat illegal loggings and encroachment on forest lands.</li> <li>▪ Illegal loggings and forest land abuses are still at large.</li> <li>▪ Forest rehabilitation and preservation are still very critical.</li> <li>▪ Small scale management of forest exploitation to meet domestic consumption is hard to materialize when forest communities are still weak.</li> </ul>

**Source:** EIC, compiled from various government sources and interviews.

The FA has made concerted efforts to implement government pledges and actively take part in the preparation of regulations to combat illegal logging and encroachments on forest areas. Information on forest concession review are open to the public and 274 forestry communities have been established in 19 provinces with support from non-governmental organizations and the FA. The government issued a sub-decree and the decision to go ahead with the forest inventory, demarcation, and to control encroachment on inundated sea forest. To maintain 11 million ha of forest areas, the target of the Cambodian Millennium Development Goal, by 2015, about 1 million ha have to be demarcated annually.

The reforms are still facing an uphill struggle due to many remaining problems. More than 220,000 ha of forest lands have been cleared and are under private possession. Forest offenses are still at large although 771 of which were suppressed by the FA in 2004. The FA faces some difficulties in bringing forest abuses to court due to a lack of incentives of prosecutors to cooperate with officials. Some of the FA officials have faced death threats, confronted with powerful and armed men<sup>45</sup>. Like most government institutions, the FA is under funded and its capacity to manage and enforce regulations is limited. Successes in forestry reforms depend on strong commitment and the government's responsibility and adequate financing.

### **11.3. Fisheries Management Reforms**

In an effort to address problems and promises at last year's CG meeting, the Royal Decree was signed by the King and Sub-decree on Management of Community Fisheries was finally adopted. "Fisheries Development Action Plan 2005 – 2008" was signed by the Prime Minister. But the draft Law on Fisheries is still pending at the National Assembly. Other legal documents on the sector are drafted. A draft sample of the statute of the fishing community is under preparation and public national consultation is planned to be conducted in August 2005

The Department of Fishery has made some progress in management of both fresh and marine fishing activities. Marine fishing activities have been identified and registered. Open biddings for fishing lots were conducted, and illegal fishing activities have been suppressed. Fishing yields in the first half of 2005 increased by 25 percent compared with that of 2004. However, aquaculture seems to decrease at the same period. Up to date, 388 fishing communities have been established with total membership

---

<sup>45</sup> Interview with Chief of Forestry Administration and Cambodia: Forestry Statistics 2004.

of 111.341 households<sup>46</sup> and more than 0.5 million ha of fishing areas have been released for family fishing purposes.

However, the country continues to suffer from over exploitation to meet pressing demand for fish consumption. Most urgent problems are still on the protection of fishing shelters (inundated forests), demarcation of fishing areas and poor management of fishing communities that causes conflicts. Some released fishing areas for community purposes have been commercialized which has created disputes within and between fishing communities. Illegal fishing does not seem to abate. Throughout the country, about only 100 fishery officials are authorized by the general prosecutor to enforce and suppress illegal fishing activities<sup>47</sup>.

**Table 11.2: Recent Developments in Fisheries Reform**

Progress	Remained Issues
<ul style="list-style-type: none"> <li>▪ Royal Decree No.0505/240 on the Establishment of Fishing Community, dated 29/05/2005.</li> <li>▪ Sub-Decree No. 80 on Management of Fishing Community, dated 10/06/2005.</li> <li>▪ Ongoing fishing lot reforms and establishment of community fisheries.</li> <li>▪ Long-term strategy and action plans have been approved.</li> <li>▪ Promoting aquaculture and continued efforts in combating illegal fishing.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Demarcations of fishing areas are still not clear causing many disputes and violations.</li> <li>▪ Serious punishment on large-scale illegal fishing activities and use of banned fishing gears.</li> <li>▪ Improving management of marine fishing and protecting marine fishing areas of the country.</li> <li>▪ Strengthening capacity of community fisheries.</li> </ul>

**Source:** EIC, compiled from various government sources and interviews.

Limited capacity of officials, lack of coordination from local authorities and armed forces, and poor resources also ruin effective and efficient operations of the department for research and the protection of inundated forests. Some inundated forests were cleared by the poor hired by the rich so that they could buy at a cheap price for their personal possession<sup>48</sup>. Fishing communities will not be able to sustain themselves without technical and financial support to manage their own fishing areas.

<sup>46</sup> Department of Fishery's report of the first semester 2005.

<sup>47</sup> Interview with General Director of Department of Fishery.

<sup>48</sup> Ibid.

Maintaining fish stock is fundamental for the livelihood of those depending on it and sustainable food supply for the country. It requires participation from relevant stakeholders. Awareness should be raised on preservation and be part of the educational curriculum. Development of other sectors such as construction of irrigation systems, use of chemical substances in agriculture and industry must take the viability of fishery into account. It also needs closer cooperation with other countries in the Mekong upstream to divert side-effects and secure a regular water regime favorable for fish reproduction in the region.

## Concluding Remarks

High economic growth performance in Cambodia in the last decade is no longer pleasant news for either the government or stakeholders. The shift is now on poverty reduction which is playing a pivotal role in shaping policy process for development. The simple reason is that there is no automatic mechanism to ensure simultaneous growth and poverty reduction. The growth is not concomitant with social improvement such as poverty, health, and education.

The baseline is no longer “year zero” from 1975 – 1979 during which the country was plunged into the darkest pages in its history, the disaster and genocide, such that survival was the only ultimate hope of every Cambodian. Expectations on prosperity and national pride on the international stage are now unsurprisingly high in which the majority of stakeholders believe that Cambodia deserves, given her rich, natural and cultural resources.

Concentration of growth and marginal trickle down effects of economic growth on income distribution and poverty reduction in the past decade requires an acceleration of reforms across sectors. Development will not change the distribution of innate ability, and therefore will not change the distribution of income. Higher public investments in physical and social infrastructures are highly critical to mitigate and alter the current pattern that requires an effective and efficient mobilization and utilization of both national revenues and foreign assistance.

There are no other suggestions except furnishing the measures that have been already prescribed by the government itself in poverty reduction and the Rectangular Strategy. However, several reforms, if achieved, would help redistribute gains from economic growth. While the reforms in the areas of land and natural resource management, with particular emphasis on the landless and land poor, will directly benefit the poor, those in legal and judicial systems, public administration, banking, finance, public finance, trade will provide more rooms for the private sector to lead the growth, job creation, and better public service deliveries.

As evidence from the latest reports of the World Bank and EIC on “Doing Business 2006” and “Cambodia’s Competitive Report 2004 -2005”, Cambodia is ranked very low in the world and not an ideal destination for investment and business. The most cited obstacle is rampant corruption which is a result of the slow progress of reforms in the legal and judicial systems and public sector management. The unreliable public sectors and

justice systems mean poor law enforcement which provides an unpredictable and a costly environment for a secure living space, let alone for business transactions. If these reforms fail to materialize, the prospect for future growth and poverty reduction is simply far too remote.

## Bibliographic References

- Asian Development Bank. 2001. *Financial Sector Blueprint for 2001-2010*. It is also available at [http://www.adb.org/Documents/Reports/-CAM\\_Blueprint/](http://www.adb.org/Documents/Reports/-CAM_Blueprint/)
- Asia Insurance Review. 2005. *Country Profile Cambodia*. Singapore: Ins Communication Pte. Ltd.
- Cambodia Daily. 2005. *Officials Seek To Reduce Number of Soldiers, September 16, 2005*.
- \_\_\_\_\_. 2005. *PM: Judiciary To Be Fixed By 'Iron Fist', March 4, 2005*.
- \_\_\_\_\_. 2005. *Criticisms of Anti Corruption Law Discuss, August 19, 2005*.
- CGAP. 2005. *Country Level Effectiveness and Accountability Review: Cambodia*.
- Chan, Vuthy and Sok, Klara. 2005. *Cambodia Competitiveness Report 2005-2006*. Phnom Penh: Economic Institute of Cambodia.
- Council for Administrative Reform. 2002. *Priority Mission Group (PMG)*.
- \_\_\_\_\_. 2004a. *National Program for Administrative Reform 2004-2008*.
- \_\_\_\_\_. 2004b. *Priority Action Plan 2005*.
- \_\_\_\_\_. 2005c. *Report on Administrative Reform of CAR in 1<sup>st</sup> semester 2005*.
- Council for Development of Cambodia. 2004. *Development Cooperation Report 2002 and 2003*.
- Council for Legal and Judicial Reform. 2005. *Plan of Action for Implementing the Legal and Judicial Reform Strategy*.
- \_\_\_\_\_. 2003. *Legal and Judicial Reform*.
- Ministry of National Assembly and Senate Relation and Inspection. 2005. *Draft Law on Anti-Corruption*.
- Economic Institute of Cambodia. 2005a. *Cambodia Poverty Assessment: Regional Case Studies*. Forthcoming.
- \_\_\_\_\_. 2005b. *Cambodia Economic Watch, April 2005*. Phnom Penh: Economic Institute of Cambodia.

- \_\_\_\_\_. 2004. *Survey on Social Justice and WTO Membership*. In Cambodia Economic Report, p.95-116. Phnom Penh: Economic Institute of Cambodia.
- GTZ and Oxfam. 2004. *Poverty and Social Impact Assessment of Social Land Concession in Cambodia: Landlessness Assessment*.
- International Monetary Fund. 2004a. *2004 Article IV Consultation*. IMF Country Report No. 04/328. <http://imf.org/external/pubs/ft/scr/2004/cr04328.pdf>
- \_\_\_\_\_. 2004b. *Cambodia: Selected Issues*. IMF Country Report No. 04/331. <http://www.imf.org/external/pubs/ft/scr/2004/cr04331.pdf>
- Meier, G.M., and Rauch, J.E. (2000). *Leading Issues in Economic Development*. p.375, 7<sup>th</sup> Ed. New York and Oxford: Oxford University Press.
- Ministry of Agriculture, Forestry and Fisheries, Department of Fishery. *Report of the First Semester 2005*.
- Ministry of Economy and Finance, Insurance Division. 2005. *Law, Sub-decrees and Regulations on Insurance*. Phnom Penh: MEF.
- \_\_\_\_\_. *Prakas No. 162 on Establishment of Working Group on Stamp Tax and Taxes on Unused Lands dated 15/03/2005*.
- \_\_\_\_\_. *Prakas No. 386 dated 20/10/2004. Procedures in Exchange of State Fixed Assets for Ministries, Institutions, Cities and Provinces*.
- Ministry of Commerce. 2005a. *Work Program of Royal Government of Cambodia Resulting from Cambodia Accession to the World Trade Organization*. Revised at MoC as of May 2005.
- \_\_\_\_\_. 2005b. *National Export Strategy 2006-2008, Draft Report*. Phnom Penh: Ministry of Commerce and International Trade Center.
- Ministry of Land Management, Urban Planning, and Construction. 2005. *Report on Achievement during 2000 – 2004 and Prospects*.
- Ministry of Tourism. *Tourism Statistical Report, various issues 2002-2004*.
- National Bank of Cambodia. 2004. *Annual Report 2004*. Phnom Penh: NBC.

- . *NBC Quarterly Review No. 13, 12 & 11*. Phnom Penh: NBC.
- National Institute of Statistics. 2005. *National Accounts of Cambodia, 1993-2004*.
- \_\_\_\_\_. *Consumer Price Index, various issues*.
- Official Gazettes. 2005. *January-September 2005*.
- Royal Government of Cambodia. 2002. *National Poverty Reduction Strategy 2003 – 2005*.
- \_\_\_\_\_. *Circulation No. 05 dated 01/07/2005 on Awarding Economic Land Concession for Investment in the framework to implement Order No. 02 dated 13/06/2005 on Strengthening Management of State Assets*.
- Secretariat of Government-Donor Coordination Committee (GDCC). 2005. *Summary of TWG's Progress Report for the Period of June-August 2005*. Fourth GDCC Meeting. Available at <http://www.cdc-crdb.gov.kh/cdc/gdcc/default.htm>
- Sen, Amartya. 1999. *Development as Freedom*. Oxford University Press.
- Sok, Hach. 2005. *Measuring Competitiveness and Labor Productivity in Cambodia's Garment Industry*. EIC Economic Review, Volume 2, No. 2, April – June, 2005, p. 2-7.
- Supreme Council for State Reform. 2005. *Draft Governance Action Plan II 2005 – 2008*.
- World Bank. 2005. *Cambodia Country Assistance Strategy of the World Bank Group 2005-2008*. World Bank: Cambodia.
- \_\_\_\_\_. 2002. *Land Management and Administration Project, January 29, 2002*.



**Appendix  
I**

**CAMBODIA  
COMPETITIVENESS  
REPORT 2005-2006**

## CAMBODIA COMPETITIVENESS REPORT 2005-2006

Whether Cambodia can gain benefits from globalization remains a major concern among stakeholders who support the country's development. Since there is no unique process to achieve high sustainable economic growth, the question is how competitive Cambodia and its businesses are on the international market. Cambodia's competitiveness emerges as a central concern for its development.

The Cambodia Competitiveness Report intends to comprehensively assess the country's competitiveness through the observations of top business executives on various aspects of Cambodia's economic environment, in order to eventually aggregate and to analyse their perceptions on issues related to national competitiveness. The report contains three basic sets of findings. First, it details outcomes of an executive opinion survey conducted among leading business executives in Cambodia. Second, it deals with the Growth Competitiveness Index of the WEF in which Cambodia is compared to its competitors. Third, Cambodia's performance is assessed within the framework of the Business Competitiveness Index of Professor Michael E Porter.

The first index highlights Cambodia's competitiveness from the quality of its macroeconomic environment, public institutions and technology, while the second index focuses more on micro components, with a strong emphasis on the quality of a country's business environment to support the high productivity of its businesses. Findings from both indexes are drawn primarily from a combination of the survey data and hard data from each country. They are complementary, allowing us to comprehensively cover the notion of competitiveness from both a macro and micro point of view.

Both indexes presented Cambodia with a relatively low score compared to the rest of the world. The Growth Competitiveness Index puts Cambodia in 112th position among 117 countries assessed this year by the World Economic Forum. Prof. Michael Porter's Business Competitiveness Index ranks Cambodia as 109th out of 116 countries. Cambodia's poor performance relates to the country's comparative weaknesses in different areas assessed by the indexes.

Cambodia's macroeconomic environment is characterized by high government deficit, high lending-borrowing interest rate spread, difficulty in acquiring business credit and wastefulness of government spending. Besides the country's macroeconomic uncertainty, Cambodia is still considered one of the world's riskier countries to invest in. Government efforts to reduce poverty are seen as insufficient in order to achieve the Millennium Development Goals.

Cambodian public institutions are a disadvantage to the country, believed to negatively affect the process of development. The perceived serious level of corruption and the weak enforcement of contracts and laws incite a lack of confidence among business people, investors and the public. The judiciary is seen as hardly independent from external

influences, while the legal framework is reported inefficient for private businesses to settle disputes or challenge the legality of the government's actions. Government decision making is not considered neutral.

Consistently with the findings of the World Bank's report, corruption has been judged pervasive in Cambodia, the leading constraint for doing business in Cambodia. The use of unofficial payments is still widespread in order to receive satisfactory public services.

Being a technology follower, Cambodia is believed to obtain technology mainly from FDIs. With an unclear policy towards the promotion of ICT, Cambodia's weaknesses can be identified in various areas such as a low level of technological readiness; rare company spending on research and development; limited internet access in schools; insufficient competition among ISPs; and unavailability of laws relating to ICT.

**Table A1.1 : Growth Competitiveness Index for 2005 (Selected Countries)**

Country	GCI		Macroeconomic environment Index		Public Institutions Index		Technology Index	
	Rank	Score*	Rank	Score*	Rank	Score*	Rank	Score*
Finland	1	5.94	4	5.52	5	6.19	2	6.02
United States	2	5.81	23	5.07	18	5.77	1	6.19
Singapore	6	5.48	1	5.82	4	6.25	10	4.93
Japan	12	5.18	42	4.40	14	5.84	8	5.24
Thailand	36	4.50	26	4.94	41	4.88	43	3.69
China	49	4.07	33	4.61	56	4.41	64	3.18
Indonesia	74	3.53	64	3.89	89	3.58	66	3.13
Vietnam	81	3.37	60	3.96	97	3.43	92	2.72
Bangladesh	110	2.86	83	3.43	117	2.55	101	2.06
Cambodia	112	2.82	104	3.04	114	2.90	105	2.51
Paraguay	113	2.80	102	3.07	112	2.97	111	2.35
Benin	114	2.74	101	3.08	110	3.06	116	2.09
Guyana	115	2.73	113	2.77	109	3.01	112	2.34
Kyrgyz Republic	116	2.62	115	2.62	115	2.89	113	2.34
Chad	117	2.37	114	2.67	116	2.64	117	1.80

Source: World Economic Forum, *Global Competitiveness Report 2005-2006*, September 2005.

\* 1: the least competitive, 7: the most competitive.

Cambodian human resources are perceived to be in general of low quality and low education. The public educational system was observed as very poor, hardly able to be the breeding ground for a competitive economy. Cambodian people were however perceived as

particularly willing to learn and very flexible, which was appreciated by the business community.

The majority of companies in Cambodia were recognized as deriving their competitiveness in international markets from local natural resources, which is a harmful situation as Cambodia's natural resources have dramatically declined during the past decade. In addition, the perceived lack of value added, foreign control of international distribution, unsophisticated production processes and the limited extent of marketing are notable weaknesses in the area of company operations and strategies.

As a relative concept, competitiveness only exists through comparison. Five countries were chosen as specific benchmarks in order to compare Cambodia's competitiveness: Thailand, China, Vietnam, Indonesia and Bangladesh. Overall, the benchmarking shows that Cambodia's competitiveness lags far behind its main neighbouring countries: Vietnam, Thailand, China and Indonesia, but is comparable to Bangladesh.

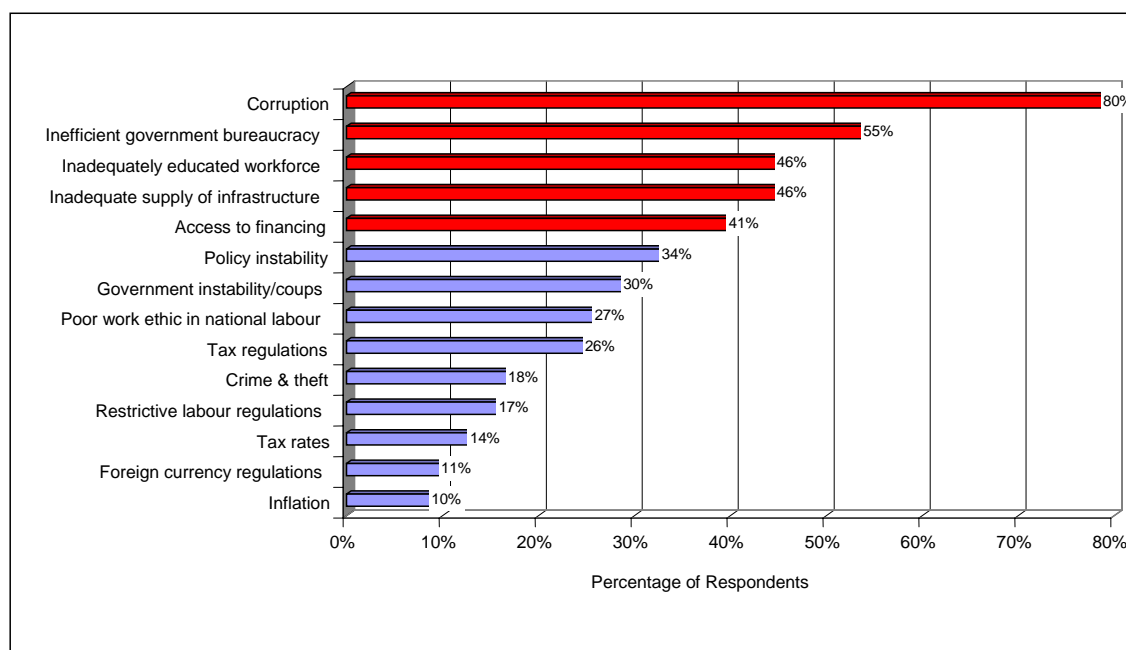
Out of the six countries, Cambodia's macroeconomic environment was viewed as the least favourable, although the business community was somewhat optimistic about the country's economy in the short-term. The country's relative weaknesses in this area are seen as high trade deficit, high public debt, high lending-borrowing interest rate spread and difficulty in receiving credit for business. The uncertain ability of the country to meet its debt obligation is another concern, reflecting the lowest country credit rating out of the benchmarking countries. Despite its small amount, the business community views government spending in Cambodia as less wasteful than in Bangladesh and Vietnam.

The perceived quality of Cambodian public institutions is among the worst in the world, and comparable with Bangladesh, while the other benchmark countries ranked higher. Noticeably, corruption is the most problematic factor for doing business in Cambodia, according to the business community. It has become more sensitive as compared to the parallel findings from the World Bank's investment climate in 2004. According to the opinion survey results, the second most problematic factor is an inefficient government bureaucracy, followed by an inadequate educated workforce, inadequate infrastructure and poor access to financing.

As a non-core economy, innovation is not an important source of technology in Cambodia, with technology being transferred through FDI. Usually, companies in Cambodia do not spend heavily on research and development. Neither do they have good business collaborations in R&D with local universities, causing Cambodia's level of technological readiness to lag far behind many other countries.

*“Corruption is the most problematic issue that we face, because it really diminishes one’s willingness to invest. It also adds a lot of hidden cost. It is one of the biggest, if not the biggest challenge that we face.”*

**Figure 1: The Most Problematic Factors for Doing Business in Cambodia**



**Note:** From a list of 14 factors, respondents were asked to select the five most problematic factors for doing business in Cambodia.

**Source:** EIC, Executive Opinion Survey 2005 in Cambodia, February-April 2005.

The quality of Cambodia's business environment ranks below Thailand, Indonesia, China, Vietnam and Bangladesh, which is the result of poor performances in the areas related to the four components of Porter's national competitive advantage: input conditions, demand conditions, related and supporting industry and context for firm strategy and rivalry. Particular notes should be observed in connection with the poor infrastructures (physical and administrative) input conditions and lack of supporting industry for business.

In order to remove Cambodia's business environment constraints and restore national competitiveness, critical reforms are necessary. Public administrative reforms were viewed as the most critical to achieve business development, followed by legal and judicial reforms, and financing and banking reforms.

*"Certain reforms have to be done. But, really, it is a question of implementation. It depends on how the government is committed to execute the reforms. I believe that there is an effort. But the question is of following it through."*

Governance and the rule of law must be ensured for public as well as investor confidence. Only then can Cambodia attract more investment, both domestic and foreign, that would bring in new, innovative and productive technology. Only when public institutions can deliver necessary services and corruption is curbed can the country's

business environment be improved, which will provide opportunities for companies to upgrade their operations and strategies so that they become competitive on the international markets. Without the proper functioning of its public institutions, Cambodia will not be able to become competitive.

Furthermore, some initiatives should prioritize the areas considered as the most disadvantageous for Cambodia's competitiveness. The quality of human resources can be improved through strengthening the country's educational system. The quality of education should be high not only for public schools but also for higher education, particularly in business and management schools in order to meet business requirements.

The establishment of a National Competitiveness Council should be another critical initiative so that the country's competitiveness can be monitored and policy recommendations can be sent out to improve the national competitiveness. The council could be established as an independent department or as part of the government's body but should come into existence as permanent, rather than on a project-basis. This would allow Cambodia to know its competitive position vis-à-vis other countries and thus be ready to compete in the global economy.

**Appendix  
II**

**KEY ECONOMIC  
INDICATORS**



**Table A2.1: Main Economic Indicators**

	1960	1990	2000	2001	2002	2003	2004	2005	2006
Nominal GDP (million US\$)	577	1,404	3,651	3,787	4,079	4,355	4,888	5,302	5,731
Real GDP (% increase)	4.8%	0.9%	8.4%	5.5%	5.2%	7.0%	7.7%	5.1%	4.9%
GDP per Capita (US\$)	106	148	288	293	310	325	357	380	404
GDP per Capita (% increase)	-	7.1%	2.0%	1.9%	5.7%	4.8%	10.1%	6.4%	6.1%
Riel/Dollar Parity (year average)	35	537	3,859	3,924	3,921	3,975	4,016	4,100	4,200
Inflation in Riel (year average)	4.0%	141.0%	-0.7%	-0.9%	0.0%	1.0%	3.9%	5.3%	6.0%
Inflation in Dollar (year average)	4.0%	0.4%	-1.8%	-2.5%	0.1%	-0.3%	2.9%	3.2%	3.5%
Budget Revenue (% GDP)	19.7%	3.1%	10.2%	10.5%	11.0%	10.2%	10.8%	10.9%	10.8%
Budget Expenditure (% GDP)	29.2%	15.9%	15.0%	16.1%	17.3%	15.9%	15.1%	15.3%	14.9%
Current Public Deficit (% GDP)	-3.8%	-11.9%	1.3%	1.1%	1.0%	0.9%	1.7%	1.6%	1.4%
Overall Public Deficit (% GDP)	-9.5%	-12.8%	-4.8%	-5.6%	-6.3%	-5.7%	-4.3%	-4.4%	-4.1%
Export of Goods (% GDP)	13.8%	7.8%	40.6%	42.1%	42.1%	47.4%	48.3%	48.3%	48.1%
Import of Goods (% GDP)	20.4%	24.3%	52.2%	54.8%	55.6%	59.0%	63.8%	67.8%	65.2%
Trade Balance (% GDP)	-6.6%	-16.5%	-11.7%	-12.6%	-13.5%	-11.5%	-15.5%	-19.5%	-17.1%
Current Account Balance (% GDP)	-7.9%	-16.7%	-8.7%	-9.8%	-10.6%	-9.5%	-13.2%	-16.9%	-14.0%
Net Foreign Reserves (million US\$)	57	0	411	467	567	635	677	696	715
Money - M1 (% GDP)	12.5%	5.3%	3.5%	4.1%	4.8%	5.2%	5.7%	5.5%	5.6%
Money - M2 (% GDP)	36.2%	7.1%	12.9%	15.0%	18.0%	19.2%	22.0%	23.0%	23.8%
Population (million)	5.5	9.5	12.7	12.9	13.2	13.4	13.7	13.9	14.2
Labor Force (% Population)	43.9%	41.7%	42.8%	43.6%	44.3%	45.0%	45.8%	46.6%	47.3%

**Source:** 1960-2004, *EIC*. Compiled from government and international organization primary data. 2005-2006 *EIC* model projection.

**Table A2.2: Budget Operations (Billion Riel)**

	1960	1990	2000	2001	2002	2003	2004	2005	2006
<b>Domestic Revenue</b>	<b>4</b>	<b>23</b>	<b>1,442</b>	<b>1,561</b>	<b>1,762</b>	<b>1,765</b>	<b>2,127</b>	<b>2,369</b>	<b>2,604</b>
<b>Current Revenue</b>	<b>4</b>	<b>23</b>	<b>1,412</b>	<b>1,552</b>	<b>1,746</b>	<b>1,733</b>	<b>2,107</b>	<b>2,352</b>	<b>2,604</b>
<b>Tax Revenue</b>	<b>3</b>	<b>13</b>	<b>1,059</b>	<b>1,129</b>	<b>1,249</b>	<b>1,220</b>	<b>1,577</b>	<b>1,871</b>	<b>2,088</b>
<b>Direct Taxes</b>	<b>1</b>	<b>1</b>	<b>136</b>	<b>140</b>	<b>126</b>	<b>150</b>	<b>158</b>	<b>169</b>	<b>191</b>
<b>Indirect Taxes</b>	<b>2</b>	<b>4</b>	<b>533</b>	<b>612</b>	<b>700</b>	<b>675</b>	<b>906</b>	<b>1,090</b>	<b>1,209</b>
VAT	1	2	398	422	452	460	598	699	788
Excise duties	0	0	113	155	210	198	304	387	417
Others	1	2	22	36	37	17	4	4	5
<b>Int'l Trade Taxes</b>	<b>1</b>	<b>9</b>	<b>391</b>	<b>376</b>	<b>424</b>	<b>395</b>	<b>513</b>	<b>612</b>	<b>688</b>
Imports	1	9	373	364	408	375	491	559	633
Exports	0	0	16	10	14	18	19	12	13
Others	0	0	2	2	2	2	3	41	42
<b>Non tax revenue</b>	<b>1</b>	<b>10</b>	<b>353</b>	<b>424</b>	<b>497</b>	<b>513</b>	<b>530</b>	<b>482</b>	<b>516</b>
Fishery & Forestry	0	0	51	35	24	13	9	9	9
Civil Aviation	0	0	25	41	34	22	27	28	34
Royalties	0	0	12	3	3	5	8	8	8
PTT	0	0	92	122	121	120	94	111	122
Other non tax revenue	1	10	174	223	315	354	392	326	342
<b>Capital Revenue</b>	<b>0</b>	<b>0</b>	<b>29</b>	<b>9</b>	<b>16</b>	<b>31</b>	<b>20</b>	<b>16</b>	<b>0</b>
<b>Expenditures</b>	<b>6</b>	<b>120</b>	<b>2,120</b>	<b>2,387</b>	<b>2,770</b>	<b>2,757</b>	<b>2,962</b>	<b>3,333</b>	<b>3,589</b>
<b>Capital Expenditures</b>	<b>1</b>	<b>7</b>	<b>897</b>	<b>996</b>	<b>1,191</b>	<b>1,171</b>	<b>1,193</b>	<b>1,329</b>	<b>1,333</b>
Through Nat'l Treasury	1	7	303	283	288	333	296	407	371
Direct Foreign financed	0	0	594	713	903	838	896	922	962
<b>Current Expenditures</b>	<b>5</b>	<b>113</b>	<b>1,223</b>	<b>1,391</b>	<b>1,579</b>	<b>1,586</b>	<b>1,769</b>	<b>2,004</b>	<b>2,256</b>
Defense and Security	2	89	438	405	387	411	423	507	580
Salaries	1	9	301	274	282	287	296	355	406
Other	1	80	137	131	105	124	127	152	174
Civil Administration	3	25	785	986	1,192	1,175	1,346	1,497	1,676
Salaries	2	12	211	214	304	327	343	386	441
Other	1	13	574	772	888	848	1,003	1,111	1,235
<b>Current deficit</b>	<b>-1</b>	<b>-90</b>	<b>190</b>	<b>161</b>	<b>167</b>	<b>147</b>	<b>338</b>	<b>348</b>	<b>347</b>
<b>Overall deficit</b>	<b>-2</b>	<b>-97</b>	<b>-678</b>	<b>-826</b>	<b>-1,008</b>	<b>-992</b>	<b>-835</b>	<b>-964</b>	<b>-985</b>
<b>Financing</b>	<b>2</b>	<b>97</b>	<b>678</b>	<b>826</b>	<b>1,008</b>	<b>992</b>	<b>835</b>	<b>964</b>	<b>985</b>
<b>Foreign financing</b>	<b>1</b>	<b>77</b>	<b>707</b>	<b>763</b>	<b>1,074</b>	<b>886</b>	<b>894</b>	<b>977</b>	<b>1,005</b>
Grants	1	70	384	396	451	382	372	410	437
Loans (net)	0	7	323	367	622	504	522	567	568
<b>Domestic financed</b>	<b>1</b>	<b>20</b>	<b>-28</b>	<b>62</b>	<b>-65</b>	<b>106</b>	<b>-113</b>	<b>0</b>	<b>0</b>
Banks	0	20	-115	-60	-104	-3	25	0	0
Others	0	0	86	122	38	109	-138	0	0

Source: 1960-2004, MEF. 2005-2006, EIC model projection.

**Table A2.3: Balance of Payment (Million US\$)**

	1960	1990	2000	2001	2002	2003	2004	2005	2006
<i>Exports of Goods</i>	N/A	N/A	1,401	1,571	1,750	2,046	2,337	2,535	2,731
<i>Imports of Goods</i>	N/A	N/A	1,939	2,094	2,314	2,596	3,152	3,634	3,778
<b>Trade Balance</b>	<b>N/A</b>	<b>N/A</b>	<b>-538</b>	<b>-523</b>	<b>-563</b>	<b>-549</b>	<b>-815</b>	<b>-1,099</b>	<b>-1,047</b>
Agriculture	N/A	N/A	210	153	99	181	90	93	118
Textiles & Garments	N/A	N/A	298	357	421	516	652	721	780
Oil & Gas	N/A	N/A	-380	-392	-460	-552	-819	-1,040	-1,028
Other Goods	N/A	N/A	-666	-641	-624	-695	-739	-873	-917
<b>Balance of Services</b>	<b>N/A</b>	<b>N/A</b>	<b>101</b>	<b>177</b>	<b>230</b>	<b>132</b>	<b>201</b>	<b>287</b>	<b>376</b>
Transportation	N/A	N/A	-99	-100	-125	-151	-212	-288	-371
Travel (Tourism)	N/A	N/A	271	343	415	353	505	692	891
Others	N/A	N/A	-71	-66	-60	-70	-91	-117	-144
<b>Balance of Incomes</b>	<b>N/A</b>	<b>N/A</b>	<b>-122</b>	<b>-136</b>	<b>-169</b>	<b>-183</b>	<b>-226</b>	<b>-290</b>	<b>-339</b>
<b>Current Transfers (net)</b>	<b>N/A</b>	<b>N/A</b>	<b>425</b>	<b>396</b>	<b>447</b>	<b>475</b>	<b>474</b>	<b>499</b>	<b>515</b>
Private Transfers	N/A	N/A	170	176	196	206	211	216	221
Government Transfers	N/A	N/A	255	220	252	269	263	283	294
<b>Current Accounts</b>	<b>N/A</b>	<b>N/A</b>	<b>-135</b>	<b>-86</b>	<b>-55</b>	<b>-125</b>	<b>-366</b>	<b>-603</b>	<b>-495</b>
<b>Capital &amp; Financial Accounts</b>	<b>N/A</b>	<b>N/A</b>	<b>254</b>	<b>236</b>	<b>284</b>	<b>323</b>	<b>383</b>	<b>436</b>	<b>419</b>
Official Loans	N/A	N/A	87	94	156	149	138	145	142
Foreign Direct Investment	N/A	N/A	128	105	82	127	197	242	227
Others (net)	N/A	N/A	39	37	46	47	48	49	50
<b>Change in Foreign Reserves</b>	<b>N/A</b>	<b>N/A</b>	<b>118</b>	<b>151</b>	<b>229</b>	<b>198</b>	<b>17</b>	<b>-168</b>	<b>-76</b>

Source: 2000-2003, IMF-EIC Balance of Payments Statistics. 2004-2006, EIC model projection.

**Table A2.4: Monetary Survey (Billion Riel)**

	1960	1990	2000	2001	2002	2003	2004	2005	2006
<b>Net Foreign Assets</b>	<b>4</b>	<b>3</b>	<b>2,589</b>	<b>3,077</b>	<b>3,737</b>	<b>4,027</b>	<b>4,797</b>	<b>5,525</b>	<b>6,302</b>
Foreign Assets	4	18	3,047	3,583	4,279	4,741	5,482	6,274	7,088
Foreign Liabilities	0	-15	-458	-506	-542	-714	-685	-749	-786
<b>Net Domestic Assets</b>	<b>3</b>	<b>58</b>	<b>-758</b>	<b>-868</b>	<b>-849</b>	<b>-698</b>	<b>-467</b>	<b>-515</b>	<b>-573</b>
<b>Domestic Credit</b>	<b>3</b>	<b>59</b>	<b>905</b>	<b>865</b>	<b>942</b>	<b>1,209</b>	<b>1,608</b>	<b>1,778</b>	<b>1,965</b>
Net Claims on Government	1	41	3	-75	-119	-128	-209	-192	-176
Claims on Government	1	42	272	271	310	360	360	387	418
Deposits of Government	0	-1	-269	-346	-429	-488	-569	-579	-593
State Enterprises	0	13	3	7	2	0	0	0	0
Private Sector	2	5	899	933	1,059	1,337	1,817	1,970	2,141
<b>Other Items (net)</b>	<b>0</b>	<b>-1</b>	<b>-1,663</b>	<b>-1,733</b>	<b>-1,791</b>	<b>-1,907</b>	<b>-2,075</b>	<b>-2,293</b>	<b>-2,539</b>
<b>Total Liquidity</b>	<b>7</b>	<b>61</b>	<b>1,831</b>	<b>2,240</b>	<b>2,888</b>	<b>3,329</b>	<b>4,329</b>	<b>5,010</b>	<b>5,728</b>
<b>Narrow Money</b>	<b>5</b>	<b>61</b>	<b>540</b>	<b>640</b>	<b>813</b>	<b>937</b>	<b>1,153</b>	<b>1,252</b>	<b>1,406</b>
Currency outside Banks	3	46	495	609	766	908	1,115	1,205	1,349
Demand Deposits	3	15	45	31	47	29	38	47	57
<b>Quasi-Money</b>	<b>2</b>	<b>0</b>	<b>1,291</b>	<b>1,600</b>	<b>2,075</b>	<b>2,391</b>	<b>3,176</b>	<b>3,758</b>	<b>4,322</b>
Times and Savings Deposits	2	0	46	54	74	82	97	115	135
Foreign Currency Deposits	0	0	1,245	1,546	2,001	2,310	3,079	3,643	4,188

**Source:** 1960-2004, NBC. 2005-2006, EIC model projection.

**Table A2.5: Investment and Saving (million US\$)**

	1960	1990	2000	2001	2002	2003	2004	2005	2006
<b>Total Investment</b>	<b>116</b>	<b>129</b>	<b>603</b>	<b>630</b>	<b>689</b>	<b>758</b>	<b>837</b>	<b>954</b>	<b>981</b>
<b>Public investment</b>	<b>37</b>	<b>13</b>	<b>233</b>	<b>254</b>	<b>304</b>	<b>295</b>	<b>297</b>	<b>324</b>	<b>317</b>
Domestic financed	6	13	72	63	50	71	71	78	67
Foreign financed	31	0	160	191	254	224	226	246	250
<b>Private investment</b>	<b>79</b>	<b>116</b>	<b>371</b>	<b>377</b>	<b>385</b>	<b>463</b>	<b>540</b>	<b>630</b>	<b>664</b>
Domestic financed	74	86	243	271	303	336	343	388	437
Foreign financed	5	31	128	105	82	127	197	242	227
<b>Total Domestic financed</b>	<b>80</b>	<b>99</b>	<b>315</b>	<b>334</b>	<b>353</b>	<b>407</b>	<b>414</b>	<b>466</b>	<b>504</b>
<b>Total Foreign financed</b>	<b>36</b>	<b>31</b>	<b>288</b>	<b>296</b>	<b>335</b>	<b>350</b>	<b>423</b>	<b>488</b>	<b>477</b>
Agriculture Products	14	25	32	35	38	42	38	37	40
Equipment	37	53	192	199	181	186	176	232	210
Construction	65	51	379	396	470	529	623	685	731
<b>Total Saving</b>	<b>116</b>	<b>129</b>	<b>603</b>	<b>630</b>	<b>689</b>	<b>758</b>	<b>837</b>	<b>954</b>	<b>981</b>
<b>National saving</b>	<b>71</b>	<b>-105</b>	<b>285</b>	<b>257</b>	<b>255</b>	<b>342</b>	<b>191</b>	<b>59</b>	<b>178</b>
Government	-22	-167	49	41	42	37	84	85	83
Non Government	93	62	236	216	212	305	107	-26	95
<b>Foreign saving</b>	<b>45</b>	<b>234</b>	<b>318</b>	<b>373</b>	<b>434</b>	<b>416</b>	<b>646</b>	<b>894</b>	<b>803</b>
Grants	42	6	246	245	252	243	237	255	265
Non Grants	3	228	72	128	182	173	409	639	538

Source: 1960-2004, EIC and NIS. 2005-2006, EIC model projection.

**Table A2.6: GDP by Industry Origin at Current Prices (million US\$)**

	<b>1960</b>	<b>1990</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Agriculture</b>	<b>302</b>	<b>764</b>	<b>1,330</b>	<b>1,302</b>	<b>1,333</b>	<b>1,475</b>	<b>1,548</b>	<b>1,627</b>	<b>1,748</b>
Paddy	126	163	328	313	285	350	321	330	361
Other Crops	80	156	275	267	272	348	388	409	451
Livestock	26	102	196	208	216	215	227	251	271
Fishery	22	327	393	384	434	433	479	499	522
Rubber & Forestry	47	17	138	130	126	128	133	138	143
<b>Industry</b>	<b>89</b>	<b>170</b>	<b>780</b>	<b>876</b>	<b>1,003</b>	<b>1,120</b>	<b>1,315</b>	<b>1,408</b>	<b>1,509</b>
Garment	16	18	336	429	503	577	709	751	809
Food, Beverage & Tobacco	19	69	117	116	116	123	128	134	141
Other Manufacturing	16	49	114	107	116	118	124	132	141
Electricity, Gas & Water	5	6	15	18	22	26	30	34	38
Construction & Mining	33	28	198	207	246	276	324	357	380
<b>Services</b>	<b>186</b>	<b>470</b>	<b>1,541</b>	<b>1,609</b>	<b>1,743</b>	<b>1,761</b>	<b>2,025</b>	<b>2,267</b>	<b>2,474</b>
Transport & Communication	15	64	241	255	276	293	341	392	424
Trade	485	584	577	590	629	640	748	875	947
Hotel & Restaurants	16	3	135	175	213	189	232	241	285
Other Private Services	-407	-212	490	497	525	537	599	649	699
Public Administration	77	31	98	92	100	102	104	110	119
<b>Total GDP</b>	<b>577</b>	<b>1,404</b>	<b>3,651</b>	<b>3,787</b>	<b>4,079</b>	<b>4,355</b>	<b>4,888</b>	<b>5,302</b>	<b>5,731</b>

Source: 1960-2004, EIC and NIS. 2005-2006, EIC model projection.

**Table A2.7: GDP by Industry Origin at Constant 2000 Prices (million US\$)**

	<b>1960</b>	<b>1990</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Agriculture</b>	<b>833</b>	<b>825</b>	<b>1,330</b>	<b>1,367</b>	<b>1,329</b>	<b>1,487</b>	<b>1,457</b>	<b>1,475</b>	<b>1,532</b>
Paddy	179	199	328	330	305	372	327	325	343
Other Crops	289	147	275	275	273	352	373	381	405
Livestock	64	165	196	218	215	226	236	245	255
Fishery	219	264	393	416	419	426	411	415	419
Rubber & Forestry	82	51	138	127	117	111	110	109	109
<b>Industry</b>	<b>549</b>	<b>249</b>	<b>780</b>	<b>869</b>	<b>1,023</b>	<b>1,149</b>	<b>1,338</b>	<b>1,431</b>	<b>1,508</b>
Garment	104	5	336	432	523	612	764	828	888
Food, Beverage & Tobacco	121	83	117	121	120	126	124	126	128
Other Manufacturing	100	69	114	106	114	115	118	122	126
Electricity, Gas & Water	39	4	15	16	19	21	22	25	27
Construction & Mining	186	87	198	195	247	275	310	330	340
<b>Services</b>	<b>1,529</b>	<b>760</b>	<b>1,541</b>	<b>1,616</b>	<b>1,702</b>	<b>1,703</b>	<b>1,878</b>	<b>2,003</b>	<b>2,112</b>
Transport & Communication	125	118	241	264	284	291	309	321	335
Trade	480	561	577	607	634	642	706	750	783
Hotels & Restaurants	187	37	135	166	197	176	218	257	293
Other Private Services	142	6	490	487	495	506	563	591	614
Public Administration	596	39	98	93	93	89	83	84	86
<b>Total GDP</b>	<b>2,910</b>	<b>1,834</b>	<b>3,651</b>	<b>3,852</b>	<b>4,054</b>	<b>4,339</b>	<b>4,673</b>	<b>4,909</b>	<b>5,152</b>

**Source:** 1960-2004, EIC and NIS. 2005-2006, EIC model projection.

**Table A2.8: GDP by Expenditure Categories at Current Price**

	1960	1990	2000	2001	2002	2003	2004	2005	2006
<b>Private Consumption</b>	<b>369</b>	<b>1,302</b>	<b>3,035</b>	<b>3,164</b>	<b>3,416</b>	<b>3,611</b>	<b>4,243</b>	<b>4,722</b>	<b>4,972</b>
<b>Government Expenditure</b>	<b>132</b>	<b>211</b>	<b>317</b>	<b>355</b>	<b>403</b>	<b>399</b>	<b>440</b>	<b>489</b>	<b>537</b>
<b>Gross Domestic Formation</b>	<b>116</b>	<b>129</b>	<b>603</b>	<b>630</b>	<b>689</b>	<b>758</b>	<b>837</b>	<b>954</b>	<b>981</b>
Gross Fixed Capital Formation	116	129	603	630	689	758	837	954	981
Public	37	13	233	254	304	295	297	324	317
Private	79	116	371	377	385	463	540	630	664
<b>Exports of Goods &amp; NFS</b>	<b>82</b>	<b>117</b>	<b>1,716</b>	<b>1,836</b>	<b>1,973</b>	<b>2,286</b>	<b>2,654</b>	<b>2,946</b>	<b>3,238</b>
Goods FOB	80	109	1,481	1,596	1,717	2,066	2,359	2,559	2,757
Domestic exports	80	56	1,231	1,341	1,467	1,816	2,109	2,309	2,507
Re-exports	0	53	250	255	250	250	250	250	250
NFS	2	8	235	240	255	220	296	387	481
<b>Imports of Goods &amp; NFS</b>	<b>122</b>	<b>354</b>	<b>2,019</b>	<b>2,197</b>	<b>2,401</b>	<b>2,698</b>	<b>3,286</b>	<b>3,808</b>	<b>3,997</b>
Goods FOB	118	341	1,906	2,074	2,267	2,567	3,118	3,595	3,737
Retained imports	118	288	1,656	1,819	2,017	2,317	2,868	3,345	3,487
Re-exports	0	53	250	255	250	250	250	250	250
NFS	4	13	113	123	134	131	169	214	260
<b>Total GDP</b>	<b>577</b>	<b>1,404</b>	<b>3,651</b>	<b>3,787</b>	<b>4,079</b>	<b>4,355</b>	<b>4,888</b>	<b>5,302</b>	<b>5,731</b>

Source: 1960-2004, EIC and NIS. 2005-2006, EIC model projection.

**Table A2.9: GDP by Expenditure Categories at Constant 2000 Prices (Million US\$)**

	1960	1990	2000	2001	2002	2003	2004	2005	2006
<b>Private Consumption</b>	<b>1,389</b>	<b>1,643</b>	<b>3,035</b>	<b>3,280</b>	<b>3,488</b>	<b>3,699</b>	<b>4,188</b>	<b>4,524</b>	<b>4,624</b>
<b>Government Expenditure</b>	<b>1,013</b>	<b>265</b>	<b>317</b>	<b>360</b>	<b>374</b>	<b>346</b>	<b>348</b>	<b>371</b>	<b>390</b>
<b>Gross Domestic Formation</b>	<b>677</b>	<b>174</b>	<b>603</b>	<b>628</b>	<b>705</b>	<b>773</b>	<b>827</b>	<b>914</b>	<b>909</b>
Gross Fixed Capital Formation	677	174	603	628	705	773	827	914	909
Public	210	41	233	239	306	293	284	300	284
Private	467	132	371	389	399	480	544	614	626
<b>Exports of Goods &amp; NFS</b>	<b>448</b>	<b>128</b>	<b>1,716</b>	<b>1,932</b>	<b>2,098</b>	<b>2,408</b>	<b>2,711</b>	<b>2,913</b>	<b>3,095</b>
Goods FOB	436	120	1,481	1,675	1,820	2,172	2,405	2,526	2,630
Domestic exports	436	62	1,231	1,408	1,555	1,909	2,150	2,279	2,391
Re-exports	0	58	250	268	265	263	255	247	238
NFS	12	8	235	256	278	236	306	387	466
<b>Imports of Goods &amp; NFS</b>	<b>617</b>	<b>376</b>	<b>2,019</b>	<b>2,348</b>	<b>2,612</b>	<b>2,886</b>	<b>3,402</b>	<b>3,813</b>	<b>3,867</b>
Goods FOB	596	362	1,906	2,216	2,467	2,746	3,228	3,599	3,615
Retained imports	596	306	1,656	1,944	2,195	2,479	2,969	3,349	3,373
Re-exports	0	56	250	273	272	267	259	250	242
NFS	21	14	113	131	145	140	175	214	252
<b>Total GDP</b>	<b>2,910</b>	<b>1,834</b>	<b>3,651</b>	<b>3,852</b>	<b>4,054</b>	<b>4,339</b>	<b>4,673</b>	<b>4,909</b>	<b>5,152</b>

Source: 1960-2004, EIC and NIS. 2005-2006, EIC model projection.

**Table A2.10: Employment by Sector (000's)**

	<b>1960</b>	<b>1990</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Agriculture</b>	<b>1,922</b>	<b>2,962</b>	<b>3,625</b>	<b>3,839</b>	<b>3,827</b>	<b>3,926</b>	<b>4,031</b>	<b>4,140</b>	<b>4,246</b>
Paddy	1,522	1,997	2,559	2,730	2,708	2,781	2,857	2,936	3,014
Other Crops	234	401	436	470	468	481	496	511	525
Livestock	65	327	343	356	367	377	387	398	409
Fishery	74	193	240	245	248	251	254	256	259
Rubber & Forestry	26	44	47	38	37	36	37	38	39
<b>Industry</b>	<b>99</b>	<b>218</b>	<b>473</b>	<b>505</b>	<b>546</b>	<b>574</b>	<b>619</b>	<b>632</b>	<b>635</b>
Garment	14	37	200	230	244	257	288	292	288
Food, Beverage & Tobacco	24	72	80	81	81	84	82	83	84
Other Manufacturing	28	50	55	55	58	60	61	63	64
Electricity, Gas & Water	2	3	6	6	7	7	8	8	8
Construction & Mining	30	57	132	133	156	167	180	186	190
<b>Services</b>	<b>299</b>	<b>752</b>	<b>984</b>	<b>992</b>	<b>999</b>	<b>1,011</b>	<b>1,033</b>	<b>1,051</b>	<b>1,058</b>
Transport & Communication	28	38	55	62	65	65	68	69	71
Trade	138	270	324	344	349	358	353	356	350
Hotel & Restaurants	21	5	60	65	70	68	78	86	93
Other Private Services	54	133	162	167	171	174	188	193	198
Public Administration	58	306	383	354	344	347	347	347	347
<b>Total</b>	<b>2,320</b>	<b>3,932</b>	<b>5,082</b>	<b>5,337</b>	<b>5,372</b>	<b>5,512</b>	<b>5,683</b>	<b>5,823</b>	<b>5,939</b>

*Source: EIC. Compiled from government and international organization primary data.*