

## CAMBODIA

### **ECONOMIC WATCH**

**APRIL 2007** 







# CAMBODIA ECONOMIC WATCH

**APRIL 2007** 

**ECONOMIC INSTITUTE** of **CAMBODIA** 

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#### LIST OF ABBREVIATIONS AND ACRONYMS

ACLEDA Association of Cambodian Local Economic Development Agencies

ADB Asian Development Bank

ANZ Australia New Zealand Banking Group
ASEAN Association of Southeast Asian Nations
CAR Council for Administrative Reform

CDC Council for the Development of Cambodia CDRI Cambodia Development Resource Institute

CIS Credit Information Sharing

CLJR Council for Legal and Judicial Reform
CMDG Cambodia Millennium Development Goals

CR Cambodian Riel

D&D Decentralization and Deconcentration

DoF Department of Fishery

EIC Economic Institute of Cambodia

ESIA Environment Social Impact Assessment

EU European Union FA Forest Authority

FTAs Free Trade Agreements
FDI Foreign Direct Investment
GDP Gross Domestic Product
HDR Human Development Report

HRMIS Human Resource management Information System

HRMD Human Resource Management Practice
IFC International Finance Corporation
ILO International Labour Organization
IMF International Monetary Fund

JMI Joint Government-Donors Monitoring Indicators
MAFF Ministry of Agriculture, Forestry and Fisheries

MBPI Merit Based Pay Initiative

MDP Management Development Program
MEF Ministry of Economy and Finance

MFI Microfinance Institutions

MLMUPC Ministry of Land Management, Urban Planning, and Construction

MoC Ministry of Commerce
MoH Ministry of Health
MoJ Ministry of Justice
MoP Ministry of Planning
MoT Ministry of Tourism

MTEF Medium Term Expenditure Framework

NA National Assembly

NBC National Bank of Cambodia NCDD National Committee for D&D NIS National Institute of Statistics

NPAR National Program for Administrative Reform

OWOs One-Window Offices

PDP Professional Development Program

PFMRP Public Financial Management Reform Program

PIP Public Investment Program
PMG Priority Mission Group
RSM Royal School of Magistracy

SAD Single Administrative Document SCM Supreme Council of Magistracy SFMP Strategy Forest Management Plan

SNDD Sub-National Democratic Development

TB Treasury Bill
TF Task Force

TWGFE Technical Group on Forestry and Environment

UNDP United Nations Development Programs

WB World Bank

WEF World Economic Forum WTO World Trade Organization

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#### **FOREWORD**

With the aim of providing a broad-based economic analysis to policy makers and stakeholders, the Economic Institute of Cambodia (EIC) has great pleasure in presenting the latest issue of "Cambodia Economic Watch". This EIC series of publications not only serves as a policy-oriented research paper, but also as a reference for all readers who wish to gain a snapshot of the Cambodian economy or monitor its development.

As in previous issues, this edition presents the latest economic performance and prospects based on the analysis of current data from many reliable sources. It takes an indepth look at the trends of the main economic indicators and the progress of reform policies. It also highlights the urgent measures that need to be taken to address any of the problems encountered.

In brief, as expected at the beginning of the year, the updated data reveals that Cambodia continued to enjoy strong economic growth in 2006. This was due to the ongoing, significant growth of the garment, construction and tourism sectors, along with moderate growth in the agricultural and other sectors.

The garment and tourism sectors seem likely to fare well in 2007, but the pace of growth will be slower. Overall economic growth in 2007 will remain high and is expected to be about 8.7 percent. Nonetheless, major efforts to diversify the economy are needed for sustainable growth. The Cambodian garment industry is currently facing huge challenges from Vietnam and will face a further threat from China in 2008 when the safeguard measures, adopted by the US and the EU, expire.

We would like to thank the World Bank for its generous support. Special thanks to Chea Huot and the World Bank team for their invaluable comments, to Min Sokheang, Tuy Chak Riya, and EIC research assistants for their excellent assistance, to all EIC staff for their enthusiasm, and to other institutions and individuals too numerous to list.

Sok Hach, Director Economic Institute of Cambodia

#### **EXECUTIVE SUMMARY**

#### **Economic Growth**

In 2006, Cambodia once again enjoyed double-digit economic growth, this time at an expected rate of 10.4 percent, which came after growth of 13.4 percent in 2005 and 10 percent in 2004. Growth was still narrowly based, and was mainly boosted by the continued expansion of garment exports, construction, and the number of tourist arrivals in Cambodia. It came in spite of the sharp increases in the price of oil and other imported input costs. The Cambodian economic growth rate is expected to be 8.7 percent in 2007 and remains among the best performing economies in the region.

The growth of agricultural sector significantly declined from 13.4 in 2005 to 4.4 percent in 2006, due mainly to a slower growth of paddy production. The industry sector remains very strong and expanded by 17.1 percent in 2006, about 5 percent higher than in 2005, due mainly to a 21.9 percent increase in the garment industry. The services sector managed a growth rate of 11.4 percent in 2006, which was down from 12.1 percent in 2005, despite a significant increase of 27.7 percent in the number of foreign tourist arrivals in Cambodia. The drop was due to a slowdown in the growth of the trade, transport and communication sectors.

#### External Trade and Balance of Payment

Total exports in 2006 increased by 27 percent, to about US\$3.7 billion, reflecting strong growth in the export of garments. The export of agricultural products also increased, but remained low. Meanwhile, imports also increased significantly by 21 percent and reached about US\$4.7 billion. Imports of petroleum and raw materials, especially those related to the garment sector, made up the lion's share of that figure. As a result, the total trade deficit increased slightly in 2006, reaching more than US\$1 billion in nominal terms, or about 15 percent of nominal GDP.

The widening of the trade deficit and the deficit of income balance created a US\$0.27 billion current accounts deficit in 2006, but a significant increase of balance of services and surplus in current transfers. The deficit was financed by foreign grants and loans, and a significant increase in foreign direct investment in Cambodia. Overall, the balance of payments for 2006 was up slightly to 1.8 percent of GDP.

Of particular note is the Council for the Development of Cambodia approved 95 investment projects and about US\$2 billion of fixed assets (excluding the World City project with US\$2 billion of fixed assets) in 2006. Compared to 2005, the number of investment projects decreased slightly by 12 percent, but the fixed assets involved increased significantly, almost tripling. This was due to a number of big investment

projects that were inaugurated during 2006. Most investment projects in 2006 belonged to the garment and agro-industries.

#### Price Level and Exchange Rate

Together with high economic growth, inflation in 2006 has also significantly slowed to about 2.8 percent, down from 6.7 percent in 2005. Unlike in 2005, 2006's inflation figure was boosted mainly by high energy costs: the transportation and communication index rose by 7.4 percent due to continued increase in international oil prices as well as the rigidity of declining oil prices in the local market, while other price index grew less than 3 percent.

The lower inflation rate is accompanied by a stable exchange rate, especially with US dollar. The riel fluctuated at around CR 4,110 per US dollar. The riel also remained stable against the Vietnamese dong, trading at around 26 riel for 100 dong, but significantly depreciated against the Thai baht, by 13 percent in December of 2006 compared to December of 2005.

#### Monetary Development

During 2006, the money supply increased by 38 percent, reaching CR 6,942 billion by December. This surge was due to an impressive increase in foreign currency deposits that reflected strong activity in sectors such as tourism and garments. As a proportion of GDP, the total money supply reached 23.5 percent in 2006. On the demand side, credit to the public sector continued to decline due to an increase in government deposits and especially IMF debt relief. Credit to the private sector increased 52 percent during 2006, due mainly to lower interest rates, growth in the manufacturing and service sectors, and the expansion of the private banking system.

It is worth noting that, in spite of the gradual decrease in the interest rate for both deposits and loans, the interest rate in Cambodia remained high compared to other countries in the region. This was due to most of credits for local borrowers coming from overseas; whereas a significant amount of local deposits have gone overseas due to the high risk of unpaid loans. The informality of businesses, the lack of infrastructure or a legal framework, and poor law enforcement are factors behind this high level of risk and uncertainty, which forces banks to charge higher rates.

#### State Budget Implementation

Progress has been made in terms of collecting the planned state revenue. In 2006, Government revenue reached CR 2,918 billion, about 11 percent more than in 2005. The main source of state income in 2006 was taxation, which represented about 78 percent of total domestic revenue, whereas other sources of state income, non-tax revenues, only accounted for around 22 percent. However, the amount of revenue collected has remained

relatively steady compared to the level of nominal GDP, at an average of about 10 percent for the last few years. This rigidity was the reason that the economic growth rate realized during the period was much higher than that expected in the planned budget.

Significant progress has been also seen on the state budget expenditure side. In 2006, actual Government spending rose by 29 percent and reached CR 4,112 billion. As a share of GDP, it recovered to about 14 percent in 2006 from 12.5 percent in 2005. On average, spending on civil administration rose by 37 percent, while that on defense and security increased by just 15 percent, 7 percent more than 2005's increase. Expenditure on priority sectors also rose significantly by 23 percent compared to 12 percent in 2005, but as a share of GDP was relatively stable at about 2.7 percent.

2006's budget revenue was low compared to its expenditure. The deficit expanded to about CR1,194 billion, around 32 percent higher than that planned in the budget law, and over double 2005's deficit. This was bankrolled mainly through foreign financing, amounting to about CR 1,584 billion, of which half was grants and half was loans, since Cambodia is trying to avoid domestic debt financing.

#### **Employment and Poverty**

Data compiled from various government data reveals that Cambodia has high rate of employment, averaging 95 percent of total labor force during 1994 and 2004; this rate unfortunately covered a significant amount of under-employment. The employment is still concentrated in the agriculture sector and its structure has not changed significantly during the last decade. During 2006 daily earnings of most vulnerable worker groups declined, except garment and rice field workers whose wages significantly increased.

On the poverty side, rate reduction is judged as slow, from 47 percent in 1993/1994 to 35 percent in 2004, only about 1 percent per annum. In terms of the distribution of the poor, it is the rural areas which host the vast majority. Around 92 percent of the poor are currently concentrated in rural regions. Districts adjacent to the Tonle Sap, where people depend largely on fresh fish resources, along with plateau and mountainous zones, where the locals rely mainly on forest resources, were the poorest regions of all, with poverty headcounts of 45 percent and 56 percent respectively. Rural Tonle Sap and rural plateau/ mountain also had the worst poverty indexes, averaging 1.5 times and twice the national average, respectively.

#### **Progress of Main Reforms**

In the banking and financial sector, there has been significant progress during the last semester of 2006, such as the creation of the Credit Information System which strengthened NBC's supervisory role. Other relevant laws and regulations are drafted and being drafted. However, no measures have been taken on the regulatory framework for

banks to undertake credit card services, housing/mortgage finance, installment finance etc. Progress has been slow on the capital market and inter-bank money market development.

In the Public Financial Management Reform Program area, 89 percent of 254 activities are reported as satisfied at the end of 2006, up from 86 percent in October 2006. However, the year 2006 has brought many changes to public financial management, ranging from debt management, banking-based salary payment for senior officials, creation of audit departments for each ministry etc.

The 2007 Budget Law has brought many modifications in managing the State budget, and is now consistent with the Public Investment Program. The changes were such as reclassification of State revenue and expenditure, new calendar for budget preparation etc. Many other regulations, namely the sub-decree on public procurement, the law on government security, Prakas on the application of the State Accounting Table and Prakas on the application of the Municipality-Province Accounting Table, has been put in place to facilitate the public financial sector reform.

In trade reform during the last semester of 2006, there has been slow progress in approving legislation under the law enactment programs conforming to WTO accession. Only the Land Traffic Law was adopted by the National Assembly in December 2006. However, most of the remaining legislation is at an advanced stage, having been drafted and sent to the National Assembly. Overall, since its adhesion to the WTO, only 23 of 46 laws have been passed and the remaining must be completed by 2008.

The Single Window Project, which aimed to facilitate tax payment and documentation submission through the Internet, seems to be at an impasse because of the divergence between the World Bank and the RGC on the legal status of the agency operating the Single Window. Apart from this, the Government is very active in searching for more markets through bilateral negotiation (especially with neighboring countries) and free trade negotiation in the ASEAN framework.

On public administration, reform importantly results in the increase of public servants' remuneration by 15 percent per year through the introduction of a meritocratic system within government institutions. Consequently, the average salary of civil servants now reaches approximately US\$46 per month, which still seems to be insufficient to cover the average living expenses as commodity prices increase from day to day. The Government is now developing a medium-term strategy and action plan to further improve current pay conditions. However, there has been little improvement over the last six months.

For sub-national administrations, the development of a draft organic law on democratic development has seen notable progress during the last six months, after a long period of silence. The law had its first draft completed in December 2006 and consultations and reviews on various aspects thereof are underway within government institutions involved. The drafting process has been constrained by the greater than

expected technical and internal policy complications in the law. These require time and effort to iron out in order to avoid misunderstanding and ambiguity.

In the area of legal and judicial reform, a wide range of draft laws remains to be finalized and adopted while the last committed deadline for the completion of legal framework for trade and core legal reforms was the end of 2006. However, greater improvement has been observed over the last six months, during which time five laws conducive to the economic sector were adopted. For the eight core draft laws, in addition to the promulgation of the civil procedures code, two other codes have recently been sent to the National Assembly for discussion and adoption, leaving the other five drafts within the process of the relevant ministries and Council of Ministers. Consequently, reform of the legal framework for court organization and fighting corruption has been especially slow.

In land, forestry and fishery management reforms, progress has been seen, but many daunting challenges remain. Implementation of unused land tax and proper valuation of unused land, especially the proliferation of land disputes, need to be appropriately addressed. More effort should be put into the social land concession program as progress has been slow, otherwise the Government may not achieve the plan of 1 million titles through systematic land titling in 2007.

The Government planned to offer formal recognition to 274 existing Community Forestry sites and create an additional 200 to 400 sites. A Prime Minister's Order on the Prevention of Deforestation has been implemented and, as of January 2007, has lead to the confiscation of 207,960 hectares of illegally held forest. However, forestry crime is still pervasive.

In the fishing lot concession areas, 56.5 percent has been transformed into family fisheries so far. The number of community fishing lots has increased steadily from 440 in 2005, to 509 in 2006. However, more efforts are still needed to strengthen the sustainable management of fishing communities as 39 percent of them are without statute, 61 percent possess no map, 72 percent have no action plan, and 83% have no conservation. Conclusion

#### **Concluding Remarks**

Cambodia has enjoyed a strong economic growth rate in recent years. However, the growth remains narrow-based and concentrated mainly in the capital Phnom Penh and the tourist town, Siem Reap-Angkor. The rural-based and agricultural sectors are underdeveloped. This pattern of development has caused disparities between regions in terms of employment opportunities and income distribution. No significant change is expected in the foreseeable future, unless critical reforms gain new momentum.

The proliferation of land grabbing and land concentration threatens the livelihood of the poor and the country's stability, as the Prime Minister has warned. Rationalization and viable land redistribution have to be in place to cope with the population explosion.

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Absence of social justice has nurtured a widespread culture of impunity and corruption. The government must initiate policies to maximize social welfare by establishing itself as a benevolent state. Equitable and sustainable development can only be maintained by social justice, compassion and national pride. It can be started with adherence to professional ethics and high social morals.



# Recent Economic Developments and Outlook

#### Chapter 1

#### Cambodian Economic Growth

In 2006, Cambodia once again enjoyed double-digit economic growth, this time at an expected rate of 10.4 percent, which comes after growth of 13.4 percent in 2005 and 10 percent in 2004. This growth was mainly boosted by the continued expansion of garment exports, construction and the number of tourist arrivals in Cambodia, and came in spite of the consequences of sharp increases in the price of oil and other imported input costs. The growth of the agricultural sector expanded moderately, whereas that of non-agricultural sectors was 13.2 percent in 2006, 1 percent higher than in 2005. However, the country's overall economic growth rate for 2006 remained high, compared with an expected rate of 7.3 percent in Lao PDR, 4.5 percent in Thailand, and 8.0 percent in Vietnam, and was roughly the same as that expected for China.<sup>1</sup>

Table 1.1: Cambodia's Real GDP Growth by Sector (%, 2000 prices)

|                 | 2002  | 2003   | 2004   | 2005  | 2006e | 2007p |
|-----------------|-------|--------|--------|-------|-------|-------|
| Agriculture     | -2.1% | 11.9%  | 1.1%   | 16.4% | 4.4%  | 3.1%  |
| Paddy           | -7.8% | 22.3%  | -12.2% | 43.6% | 1.0%  | -0.3% |
| Industry        | 17.7% | 12.5%  | 16.8%  | 12.3% | 17.1% | 14.1% |
| Garments        | 21.3% | 16.8%  | 24.9%  | 10.3% | 21.9% | 17.6% |
| Services        | 6.3%  | 4.4%   | 11.7%  | 12.1% | 11.4% | 9.2%  |
| Tourism         | 18.8% | -16.7% | 23.4%  | 17.3% | 23.2% | 15.4% |
| Total GDP       | 6.2%  | 8.6%   | 10.0%  | 13.4% | 10.4% | 8.7%  |
| Non-Agriculture | 10.7% | 7.0%   | 14.5%  | 12.1% | 13.2% | 11.1% |

Sources: NIS for 2002-2006, EIC projection for 2007

Based on current economic trends, Cambodian economic growth-supporting industries, such as garments, construction and tourism, appear as though they will fare well in the coming years. The number of foreign tourist arrivals in Cambodia is expected to increase steadily. The growth in garment exports will continue until 2008, albeit at a slower rate, thanks to the effect of restrictions imposed by the US and EU on imports from China. In addition, the residential construction and real estate sectors are also expected to continue growing, at the slower rate.

<sup>&</sup>lt;sup>1</sup> East Asia Update - November 2006, The World Bank.

By contrast, the agricultural sector remains dependent on weather conditions. If, and only if, this sector were not to meet any serious problems as a result of severe drought or inundation, Cambodia would continue to enjoy high economic growth during the next few years, beginning with an expected growth rate of about 8.7 percent for 2007. Compared with other countries in the region, Cambodian economic growth during 2007 is still relatively high. However, this growth remains narrow-based.

Again, Cambodia's economic growth could be speeded up if reform in some critical areas made significant progress. Irrigation renovation and natural resource management reform are vital for agricultural growth. These reforms could limit the damage caused by adverse weather conditions, especially droughts, and slow the loss of natural resources. Other improvements, such as multifaceted reforms in trade and investment, public finance, and the legal and judicial system, are crucial for the development of industrial and service sectors. These reforms, together with effective anti-corruption policies, could provide an ideal environment and opportunity for higher economic growth. However, these changes cannot to be achieved in the short term.

#### 1.1. Agriculture

2006 was another rainy year, following on from an equally wet 2005. The agricultural sector remained natural resource-based and achieved 4.4 percent growth in 2006, down from 16.4 percent in 2005. This growth was mainly boosted by the expansion of cultivated areas, aqua-fishing, and a continued increase in livestock production. However, the agricultural sector remains volatile. Effective irrigation and natural resource management systems are still urgently required in order to achieve sustainable agricultural growth and thus poverty reduction, since the agricultural sector is the main source of income for the country's poorest inhabitants. Based on current trends, the growth of the agricultural sector is expected to slow during 2007.

Crops, especially paddy, remained the main source of income for Cambodian farmers. The weather conditions in 2006 were considered as favorable as those in 2005. Cultivated areas kept increasing even though some places were flooded by the rains. As a result, during 2006, paddy value added increased slightly by about 1 percent compared with a 43.6 percent increase in 2005, and that of other crops also continued to grow, at a slower rate of about 5.7 percent compared with 15.9 percent in 2005. An effective irrigation system and natural resource management remain urgent measures needed for the sustainable growth of crop production.

Table 1.2: Trends in the Agriculture Sector (% increase, 2000 prices)

|                   | 2002  | 2003  | 2004   | 2005  | 2006e | 2007p |
|-------------------|-------|-------|--------|-------|-------|-------|
| Paddy             | -7.8% | 22.3% | -12.2% | 43.6% | 1.0%  | -0.3% |
| Other Crops       | -0.4% | 26.7% | 16.0%  | 15.9% | 5.7%  | 6.3%  |
| Livestock         | -0.5% | 6.6%  | 4.5%   | 5.8%  | 8.2%  | 5.9%  |
| Fishery           | 0.6%  | 1.7%  | -1.7%  | 5.6%  | 3.8%  | 1.7%  |
| Rubber & Forestry | -3.0% | -2.9% | 0.5%   | 3.9%  | 6.0%  | 1.3%  |
| Total Agriculture | -2.1% | 11.9% | 1.1%   | 16.4% | 4.4%  | 3.1%  |

Sources: NIS for 2002-2006, EIC projection for 2007.

Livestock is a potential source of income for Cambodian farmers, besides the revenue they receive from unpredictable crop cultivation. During 2006, livestock production increased significantly by 8.2 percent, about 3 percent more than in 2005. This was partly because of the spillover effect of revenue from crop production in the last two years. However, limited initial capital and the inaccessibility of credit remain major constraints on livestock growth meeting even local demand. Thus, Cambodia continued to import large quantities of livestock products from neighboring countries. Based on the current trend, the growth rate of livestock production for the next few years will remain moderate.

Fishery production was high in 2006. The fisheries' value added is expected to grow slightly, by about 3.8 percent in 2006, down from 5.6 percent in 2005. Small fish, used for the production of a popular salt fish pâté, remained abundant, while normal fish production continued to be low. However, the number of illegal fishing complaints, the use of illegal fishing instruments and the destruction of essential fish rearing areas, remain important concerns for the sustainable growth of the sector. These practices have led to declining fish stocks and fewer places for the fish to breed. Thus, the prospects for expanding fish stocks in the coming years are slim.

Forestry production was projected to increase by 6.4 percent in 2006 compared with 5.4 percent in 2005. Similarly, as expected, rubber production rebounded slightly, with an increase of about 3.1 percent in 2006, after recently declining at an annual rate of around 10 percent per year. To summarize, the growth rate of the forestry and rubber sectors was slightly negative in 2006. The prospect of growth in these two sectors remains flat for the next few years.

#### 1.2. Industry

In contrast to the agricultural sector, the industrial sector maintained its strong performance and achieved a growth rate of about 17 percent in 2006, about 5 percent higher than in 2005. This growth continued to be boosted mainly by the expansion of the garment industry and construction business, combined with moderate growth in other industries. Based on the current trend, the prospects for growth in the industrial sector remain strong in the coming years, but at a slower rate. The slower rate is partly caused by Vietnam's membership in WTO.

Table 1.3: Trends of Industry Sectors (% increase, 2000 prices)

|                            | 2002  | 2003  | 2004  | 2005  | 2006e | 2007p |
|----------------------------|-------|-------|-------|-------|-------|-------|
| Garments                   | 21.3% | 16.8% | 24.9% | 10.3% | 21.9% | 17.6% |
| Food, Beverages & Tobacco  | -0.7% | 4.8%  | -0.9% | 8.0%  | 2.5%  | 5.0%  |
| Other Manufacturing        | 7.1%  | 2.5%  | 3.5%  | 10.2% | 8.6%  | 5.5%  |
| Electricity, Gas and Water | 17.1% | 15.7% | 4.7%  | 4.5%  | 4.7%  | 6.3%  |
| Construction & Mining      | 27.0% | 11.5% | 13.7% | 20.4% | 15.5% | 11.8% |
| Total Industry             | 17.7% | 12.5% | 16.8% | 12.3% | 17.1% | 14.1% |

Sources: NIS for 2002-2006, EIC projection for 2007.

The garment industry<sup>2</sup>, the industrial sector's main contributor, remained strong in 2006. According to the Customs Department of Ministry of Economy and Finance (MEF), the quantity of garment exports for 2006 increased by 32.5 percent from 2005, of which those to the US and EU markets grew by 34.3 and 23.6 percent respectively. This growth is mainly a consequence of the safeguarding measures imposed by the US and EU to restrain Chinese exports, and the labor compliance project monitored by the ILO, which created a niche market for Cambodian garment products. Cambodia's WTO membership and the reduction of export transaction bureaucracy also helped to maintain the sector's growth. In contrast, the overall unit price prices of Cambodian garment products on the world market during 2006 continued their slight decline, by about 10.7 percent, due to the emergence of many big competitors, especially

<sup>&</sup>lt;sup>2</sup> Briefly, the Cambodian garment industry is an export-oriented industry. According to the Customs Department, total exports of garment products represented more than 90 percent of total exports of merchandise. The main markets are the US and EU, which captured about 70 percent and 22 percent of Cambodian garment exports during 2006.

China. In total, Cambodia's garment industry posted another high growth rate, of about 21.9 percent, compared with 10.3 percent in 2005.

Nonetheless, it is worth noting that<sup>3</sup> 88 percent and 70 percent of Vietnamese and Chinese clothing exports to the US market, respectively, compete with those from Cambodia. Thus, the growth of the Cambodian garment industry is expected to slow down during 2007 and the coming years because of Vietnam's WTO membership and the expiration of the safeguarding measures imposed by the US and EU to restrain Chinese. Both these countries will become major competitors in terms of both FDI attraction and the export of garment products to the US market. Therefore, in order to sustain economic growth, efforts to diversify the economy should be made a priority.

Regarding other industrial sectors, the construction business's growth rate remained strong, but slowed to 15.7 percent in 2006, from 20.1 percent in 2005. This is the result of a slowdown in publicly financed construction projects, since many major roads have almost been completed, and comes in spite of continuous strong growth in garment factory, hotel, and private home construction, especially flats and apartments. The food, beverage and tobacco sectors also continued their growth at a slower rate of about 2.5 percent in 2006, compared to 8 percent in 2005, owing to a moderate increase in agricultural production. The electricity and water sectors will be virtually unchanged from their 2005 performance levels, whilst other industrial sectors will continue to grow at slow rates. However, growth will be expected to slow down in 2007.

#### 1.3. Service

Last but not least, the service sector also achieved significant growth in 2006. It expanded by about 11.4 percent, slightly down from 12.1 percent in 2005 and 11.7 percent in 2004. This is mainly due to annual increases in the number of foreign tourist arrivals in Cambodia, despite the recent threat of SARS, and a significant expansion of economic activity, especially trade, transportation, communication, and financial services. Based on current trends, the growth of the service sector is expected to continue to slow down slightly.

The hotel and restaurant sector contributed significantly to the service sector's growth, expanding by about 23.3 percent in 2006, 5 percent more than in 2005. This is due to the increasing number of international tourist arrivals in Cambodia; up by about 27.2 percent in 2006, to around 1.6

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<sup>&</sup>lt;sup>3</sup> John Nelmes from IMF at CDRI-ANZR 2007 Outlook conference.

million, compared to an increase of only 20 percent in 2005. Based on this trend, the number of foreign tourist arrivals during 2007 will continue to grow, but at a slower pace. Thus, the hotel and restaurant sector is also expected to continue its expansion at a slower rate.

Table 1.4: Trends of Service Sectors (% increase, 2000 prices)

|                               | 2002  | 2003   | 2004  | 2005  | 2006e | 2007p |
|-------------------------------|-------|--------|-------|-------|-------|-------|
| Transport & Communication     | 8.3%  | 1.3%   | 7.6%  | 13.1% | 8.9%  | 10.1% |
| Trade                         | 1.3%  | 2.0%   | 5.5%  | 8.4%  | 6.8%  | 8.0%  |
| Hotels & Restaurants          | 18.8% | -16.7% | 23.4% | 17.3% | 23.3% | 14.1% |
| Other Private Services        | 6.1%  | 15.8%  | 16.8% | 13.1% | 12.9% | 6.8%  |
| <b>Total Private Services</b> | 6.6%  | 4.9%   | 12.8% | 12.4% | 12.0% | 8.6%  |
| Public Administration         | 1.1%  | -4.0%  | -6.4% | 5.9%  | -2.0% | 4.8%  |
| Total Services                | 6.3%  | 4.4%   | 11.7% | 12.1% | 11.4% | 8.5%  |

Sources: NIS for 2002-2006, EIC projection for 2007.

Trade makes up the most significant share of the service sector, followed by transport and communication. Because of slower economic growth during 2006, the growth rate of these sectors also slowed, to about 6.8 percent for trade and 8.9 percent for transport and communication, compared to growth of 8.4 percent and 13.1 percent respectively in 2005. However, physical infrastructure remains poor, in particular roads and railways. Further rehabilitation and reconstruction of roads is still essential, in order to open up trading opportunities in remote areas of the country. Increased mobility of people, goods and services will in turn create a positive circle of market dynamics. In 2007, the growth of trade and transportation is expected to continue slowing down, given the projected slackening of economic growth this year.

Finally, during 2006 the financial and real estate sectors continued to grow significantly, by about 22.6 percent and 13.8 percent respectively, up from 19.2 percent and 7.0 percent in 2005. Other service sectors grew at slower rates in 2006, averaging around 5 percent. However, financial services are still basic and major providers are concentrated in Cambodia's main cities. Credit in rural areas is available through a few commercial banks and specialized microfinance institutions, but its dominant source appears to be informal lending (usurers). For 2007, the prospect of growth in these sectors remains moderate.

#### Chapter 2

#### Trade, Investment and Productivity

External trade and FDI have contributed largely towards boosting the Cambodian economy during the last ten years. Exports of garment products and tourism have also made substantial contributions to the country's balance of payments during that period. Cambodia's FDI seems to have been on an upward trend since 2002, thanks to investments in the garment and tourism sectors. However, continued dependence on these sectors to draw in foreign capital cannot be taken for granted, with the garment sector facing the huge upcoming challenge of competition from Vietnam, and the number of hotel rooms in Siem Reap apparently having reached saturation level.

#### 2.1. External Trade and Capital Movements

Data compiled from the National Bank of Cambodia revealed that total exports (including re-exports) in 2006 increased by 27 percent, to about US\$3.7 billion, reflecting strong growth in the export of garments. The export of agricultural products was also increased, but remained low. Meanwhile, imports also increased significantly by 21 percent and reached about US\$4.7 billion. Imports of petroleum and raw materials, especially those related to the garment sector, made up the lion's share of that figure. As a result, the total trade deficit increased slightly in 2006, reaching more than US\$1 billion in nominal terms, or about 15 percent of nominal GDP, down from 16 percent in 2005.

Due to the significant increase in the number of foreign tourist arrivals in Cambodia, the income generated from tourist spending (travel) is estimated to have reached about US\$991 million in 2006, 18 percent up on 2005. Unfortunately, revenue from tourist transportation remained low, reaching only about US\$163 million, since Cambodia does not yet have a stake in any of the airlines or other transportation industries serving the international markets funneling tourist arrivals into the country. To sum up, the surplus in the service sector improved significantly in 2006, up by 18 percent from 2005, and reaching 8 percent of GDP.

The income account for 2006 was in deficit by about US\$286 million, up by 13 percent from 2005, and represented about 4 percent of GDP. This was mainly because of large outflows of income, such as dividends and the profits of foreign investment in the country, especially the garment industry, and payments for foreign technical assistance by donors, which reached

US\$80 million. During the same period, net private transfers increased by 13 percent and reached US\$259 million in 2005. Combined with the large inflow of foreign aid, Cambodia's transfers accounted for a surplus of about US\$500 million, 7.2 percent of nominal GDP in 2006. As a result, the current account deficit decreased to US\$273 million, 24 percent down from 2005, and accounted for about 3.9 percent of GDP.

Table 2.1: Cambodia's Balance of Payments (Millions of US Dollars)

|                                      | 2002  | 2003  | 2004  | 2005   | 2006e  | 2007p  |
|--------------------------------------|-------|-------|-------|--------|--------|--------|
| Exports of Goods                     | 1,770 | 2,087 | 2,589 | 2,910  | 3,696  | 4,077  |
| Imports of Goods                     | 2,361 | 2,668 | 3,269 | 3,928  | 4,739  | 5,293  |
| Trade Balance                        | -591  | -581  | -681  | -1,018 | -1,044 | -1,216 |
| Agriculture                          | 100   | 183   | 95    | 293    | 360    | 401    |
| Textiles & Garments                  | 421   | 516   | 657   | 734    | 887    | 1,037  |
| Oil & Gas                            | -369  | -445  | -698  | -1,004 | -1,241 | -1,299 |
| Other Goods                          | -744  | -836  | -735  | -1,040 | -1,050 | -1,356 |
| <b>Balance of Services</b>           | 229   | 114   | 291   | 471    | 557    | 619    |
| Transportation                       | -128  | -157  | -194  | -233   | -272   | -341   |
| Travel                               | 415   | 353   | 556   | 743    | 868    | 1,072  |
| Others                               | -58   | -82   | -72   | -38    | -38    | -113   |
| <b>Balance of Incomes</b>            | -184  | -179  | -221  | -254   | -286   | -339   |
| <b>Current Transfers</b>             | 439   | 413   | 428   | 440    | 500    | 513    |
| Private Transfers                    | 192   | 197   | 219   | 229    | 259    | 264    |
| Government Transfers (grants)        | 247   | 217   | 209   | 211    | 241    | 249    |
| <b>Current Accounts</b>              | -107  | -233  | -183  | -360   | -273   | -423   |
| Capital & Financial Accounts         | 190   | 317   | 287   | 464    | 400    | 571    |
| Official Loans (net of amortization) | 55    | 109   | 111   | 114    | 206    | 246    |
| Foreign Direct Investment            | 145   | 84    | 131   | 381    | 399    | 376    |
| Others                               | -10   | 124   | 44    | -32    | -205   | -51    |
| Change in Foreign Reserves           | 83    | 83    | 104   | 103    | 127    | 147    |
| At the National Bank                 | 115   | 74    | 69    | 109    | 185    | 154    |
| Outside NBC                          | -32   | 10    | 35    | -6     | -58    | -7     |

Sources: NBC for 2002-2006, EIC projection for 2007.

Nevertheless, the capital and financial accounts were in surplus by about US\$400 million, reaching 6.4 percent of GDP in 2006. This surplus was down by 14 percent on 2005, because of a significant decrease in currency reserves and deposits at commercial banks, and despite significant increases in foreign direct investment in Cambodia. To sum up, the overall balance of payments was in surplus by US\$127 million, a 23 percent increase on 2005, and reached 1.8 percent of the GDP. It is worth noting that since Cambodia is a dollarized economy, with individuals and institutions able to hold foreign currency, the overall change in the balance of payments reflects not only the NBC's foreign reserves, but also the foreign currency held by other economic agencies as well as households.

For 2007, based on the current trend, it is expected that Cambodia's foreign trade, including both the export and import of goods, will continue to expand at a slower pace. The trade deficit is projected to widen, because of the expected slowdown in the growth of garment exports. The enlargement of the trade and income balance deficits will widen the current account deficit, despite a significant increase in the balance of services (given the expected increase in the number of foreign visitors to Cambodia) and a surplus in current transfers. As in 2006, the current account deficit for 2007 is expected to be financed by grants, loans and an expected rise in foreign direct investment in Cambodia. Overall, the balance of payments for 2007 is expected to show a surplus of about 1.8 percent of GDP.

#### 2.2. Private Investment and Capital Stock

In 2006, the Council for the Development of Cambodia (CDC) approved 96 investment projects and about US\$4 billion of fixed assets. Compared to 2005, the number of investment projects decreased slightly, by 8 percent, but the fixed assets involved increased significantly, almost quadrupling. This was due to a number of big investment projects <sup>4</sup> approved during 2006, which represented more than 75 percent of total approved fixed assets. Nevertheless, data released by the National Bank of Cambodia showed that actual investment implemented in 2006 reached

- World City project with US\$2 billion of fixed assets,
- Green Sea Agriculture project with US\$141 million of fixed assets,
- Cambodia Cement Chakrey Ting Factory project with US\$132 million of fixed assets,
- Sinohydro Kamchay Hydroelectric project with \$170 million of fixed assets,
- Koh Pous (Cambodia) Investment Group Ltd. with US\$278 million of fixed assets,
- and the Diamond Island development Company Ltd. with US\$369 million of fixed assets.

<sup>&</sup>lt;sup>4</sup> The big investment projects of 2006 were as follows:

only about US\$400 million, representing just 10 percent of investment approved by CDC in that year.

Most investment projects belonged to the garment and agroindustries, which accounted for 40 and 18 percent respectively of all approved investment projects. The approved investment in these two sectors accounted for US\$138 million and US\$481 million of fixed assets. This was reflected in the high growth of garment exports for 2006.

Nonetheless, it is worth noting that the number of investment projects in the agro-industry increased significantly during 2006, despite poor infrastructure and a limited pool of skilled labor. By comparison, investment projects in the garment industry and hotels and restaurants decreased considerably in 2006, even though significant growth had been projected for the garment and tourism sectors. In addition, during the same period, a considerable proportion of investment was focused on ambitious property schemes, some of which will take a considerable time to reach fruition, while others may prove to be highly speculative.

**Table 2.2: Approved Private Investment Projects** 

|  | 2001         | 2002        | 2003 | 2004 | 2005  | 2006  |  |  |  |  |  |
|--|--------------|-------------|------|------|-------|-------|--|--|--|--|--|
| Number of Approved Investment Projects |              |             |      |      |       |       |  |  |  |  |  |
| Total                                  | 188          | 37          | 66   | 60   | 104   | 96    |  |  |  |  |  |
| Garments                               | 76           | 16          | 31   | 35   | 53    | 39    |  |  |  |  |  |
| Hotels                                 | 4            | 4           | 11   | 3    | 4     | 4     |  |  |  |  |  |
| Others                                 | 108          | 17          | 24   | 22   | 47    | 53    |  |  |  |  |  |
| Fixed Assets Approv                    | ed (Millions | of US Dolla | rs)  |      |       |       |  |  |  |  |  |
| Total                                  | 217          | 240         | 314  | 231  | 1,028 | 3,980 |  |  |  |  |  |
| Garments                               | 100          | 18          | 75   | 85   | 118   | 138   |  |  |  |  |  |
| Hotels                                 | 71           | 47          | 114  | 23   | 65    | 22    |  |  |  |  |  |
| Others                                 | 46           | 175         | 125  | 123  | 845   | 3,820 |  |  |  |  |  |

Source: CDC, Cambodian Investment Board,

In 2007, the growth of investment in garment factories is uncertain, because of an increase in competition from Vietnam (in both attracting FDI and promoting exports of garments and textiles) now that it has become a full member of WTO, and despite the continued validity of US and EU safeguard measures. At the same time, given limited infrastructure development and a

lack of skilled human resources, projected growth for the agro-industry is also flat. To sum up, a slowdown in the growth of investment projects can be expected in 2007.

#### 2.3. Productivity

High economic growth has the potential to substantially reduce poverty, since it may be achieved by means of increasing productivity, which in turn allows wages to rise in real terms. This means that economic growth must create productive employment. According to EIC estimates, the growth of worker productivity in agriculture slowed down significantly to 1.7 percent in 2006, down from about 13.3 percent in 2005. This was because of slower growth in the agricultural sector. At the same time, worker productivity in the industrial and service sectors continued to increase significantly, by about 6.4 and 4.6 percent in the garment and tourism sectors respectively, because of growth in those industries. To sum up, total productivity increased by 6.5 percent in 2006, about 3 percent less than in 2005.

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

|                   | 2002  | 2003   | 2004   | 2005  | 2006e | 2007p |
|-------------------|-------|--------|--------|-------|-------|-------|
| Agriculture       | -1.9% | 8.8%   | -1.6%  | 13.3% | 1.7%  | -0.2% |
| Paddy             | -7.1% | 18.9%  | -14.6% | 39.7% | -1.6% | -2.7% |
| Industry          | 8.8%  | 6.5%   | 7.3%   | 2.6%  | 6.4%  | 5.6%  |
| Textile & Garment | 14.3% | 10.8%  | 9.4%   | 0.3%  | 6.9%  | 6.3%  |
| Private Services  | 2.6%  | 1.1%   | 7.6%   | 4.6%  | 4.6%  | 5.2%  |
| Tourism           | 10.3% | -14.3% | 8.2%   | 6.3%  | 8.2%  | 5.2%  |
| Total (*)         | 4.8%  | 6.0%   | 5.8%   | 9.2%  | 6.5%  | 4.7%  |

Source: EIC Estimates.

(\*) Excluding Public Administration.

The productivity of industry and services has improved during recent years, by around 6 and 4 percent respectively, whereas agricultural productivity, especially paddy rice, has fluctuated greatly. This is because the agricultural sector is almost totally dependent on weather conditions. Thus, the key strategy to maintain a steady level of growth in agricultural productivity is to invest in the irrigation system.

Based on the current trend and projected economic activity for 2007, agricultural productivity will continue to increase at a slower rate,

because of the expected slowdown in the growth of agricultural production compared to 2006. The productivity of the garment industry will improve due to increasing experience and extra training at factory middle-management level. Labor productivity in industry is expected to continue growing at a slower rate, and that of the service sector (excluding public administration), is also expected to improve. To sum up, the overall growth of worker productivity will reduce to 4.7 percent, reaching US\$1,044 per worker.

#### Chapter 3

#### Price and Monetary Development

The growth of Cambodia's economy will be substantial if inflation and the riel remain stable. Inflation slowed significantly in 2006, after seeing an upward trend in 2004 and 2005. However, there were still significant increases in transportation and communication prices. Despite the pressure of a deterioration in the balance of payments, the riel was relatively stable or even slightly appreciated against the US dollar, because of a significant increase in economic activities in rural areas, where the riel was largely used.

#### 3.1. Inflation

Together with high economic growth, inflation (December/December) has also slowed to about 2.8 percent in 2006, following an upward trend, from just 0.5 percent in 2003, to 6.7 percent in 2005. Unlike in 2005, 2006's inflation figure was boosted mainly by high energy costs. The transportation and communication index rose by 7.4 percent, down from 9.1 percent in 2005, because of continued increases in international oil prices as well as the rigidity of declining oil prices in the local market.

140 140 Transportation 130 130 Food 120 120 110 110 All Items 100 100 90 90 Dec-02 Jun-03 Dec-03 Jun-04 Dec-04 Jun-05 Dec-05 Jun-06 Dec-06

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

Source: EIC, compiled from National Institute of Statistics.

The growth of the food price index was only around 2 percent in 2006, a significant slowdown from about 11.1 percent in 2005. The decline

in food price inflation is also attributable to favorable climatic conditions in 2006 as well as in 2005, which resulted in high agricultural production. The stable exchange rate could be a factor too, since most consumable products as well as raw materials were imported. Other price index growth was only about 3 percent or less in 2006. By the end of 2006, Cambodia's average yearly inflation rate stood at 4.7 percent.

Based on the experience of previous years, overall inflation seems to be boosted from the producer rather than consumer side, given the limited income of most Cambodians. Higher prices for gasoline, the use of imported inputs, shortages of local agricultural products, as well as declining natural resources are the main reasons for higher inflation. This inflation is detrimental not only to local consumers, but also domestic producers, because it damages their competitiveness with regard to imported products. Effective irrigation systems, natural resource management, lowering the price of gasoline and diesel, and a stable exchange rate are crucial in order to reduce inflation, and increase the competitiveness of domestic products.

#### 3.2. Exchange Rate

In a dollarized economy, a stable exchange rate is highly appreciated. During 2006, the riel was relatively stable against the US dollar, despite the pressure of a deterioration in the balance of payments. The riel fluctuated at around CR 4,110 per US dollar (the average exchange rate during 2006). The riel appreciated slightly at the beginning of 2006 and re-depreciated from May onwards. However, it re-appreciated by about 2 percent towards the end of the year.

Besides the US dollar, the Thai baht and Vietnamese dong were also widely used in Cambodian border provinces, because of strong border trade activities. The riel remained stable against the Vietnamese dong, trading at around 26 riel for 100 dong, but significantly depreciated against the Thai baht, by about 13 percent in December of 2006 compared to December of 2005. The appreciation of the Thai baht should thus be beneficial for rural Cambodia.

The riel is rarely used in informal sector such as garment sector, but largely used in the informal sectors which are mostly located in the rural and in some urban. Thus, the relative strength of the riel was partly a result of the significant expansion in economic activities in rural areas for the last 2 years --especially activities related to agricultural products. In contrast, the slower growth expected in the agricultural sector in 2007, will lead to a slower increase in demand for the riel in 2007.

125 125 Riel Against Thai Baht 120 120 115 115 110 110 Riel Against US\$ 105 105 100 100 Riel Against Vietnamese Dong 95 95 90 90 Dec-02 Dec-03 Jun-04 Jun-03 Dec-04 Jun-05 Dec-05 Jun-06 Dec-06

Figure 3.2: Cambodian Riel against US\$, Thai baht, and Vietnamese dong (December 2002=100)

**Source:** EIC, compiled from the International Financial Statistics of the IMF.

On the other hand, surges in imports, especially of construction materials and vehicles, along with higher prices for imported petroleum and contraction materials, are factors that will lead to stronger demand for foreign exchange, especially the US dollar. Furthermore, the sending of US dollars abroad, as well as the expected slowdown in growth of the garment export industry, which accounts for the most significant inflow of US dollars into the country, will cause a shortage of that currency in Cambodia.

To sum up, strong demand for US dollars and a shortage in their supply, as well as slower increase in demand of riel will then weaken the riel against the dollar in 2007. Currency speculation could also reason in the depreciation of the riel in coming years.

#### 3.3. Money Supply

During 2006, the money supply increased by 38 percent, reaching CR 6,942 billion by December. This surge was due to an impressive increase in foreign currency deposits that reflected strong activity in sectors such as tourism and garments. As a proportion of GDP, the total money supply reached 23.5 percent in 2006, an increase from 19.8 percent in 2005.

To sum up, money continued to be dominated by foreign currency, which represented about 73 percent of the total money supply and 17.6 percent of GDP, while riel liquidity remained limited, representing only about 23 percent of total money supply recorded by the NBC and only 5.4 percent of GDP. Riel liquidity increased by 25 percent in December 2006

compared to December 2005, whereas foreign currency deposits expanded even more sharply, by about 45 percent in the same period. This trend is expected to continue into 2007, but at a slower pace because of expected competition from Vietnam's garment industry.

Table 3.1: Cambodia's Monetary Survey (Billions of Riel)

|                               | 2002  | 2003  | 2004  | 2005  | 2006  | 2007p |
|-------------------------------|-------|-------|-------|-------|-------|-------|
| <b>Total Money Supply</b>     | 2,888 | 3,329 | 4,329 | 5,025 | 6,942 | 8,196 |
| Local Currency in Circulation | 766   | 908   | 1,115 | 1,282 | 1,600 | 1,887 |
| Foreign Currency Deposits     | 2,001 | 2,310 | 3,079 | 3,589 | 5,196 | 6,130 |
| Other Liquidity               | 122   | 111   | 135   | 154   | 147   | 179   |
| <b>Total Money Demand</b>     | 2,888 | 3,329 | 4,329 | 5,025 | 6,942 | 8,196 |
| Credit to Private Sector      | 1,059 | 1,337 | 1,817 | 2,204 | 3,628 | 4,353 |
| Credit to Public Sector       | (117) | (128) | (209) | (421) | (951) | (927) |
| Other Money Demand            | 1,947 | 2,120 | 2,722 | 3,242 | 4,266 | 4,770 |

Sources: NBC for 2002-2006, EIC projection for 2007.

On the demand side, credit to the public sector continued to decline radically due to an increase in government deposits and especially IMF debt relief. Credit to the private sector increased 52 percent in December 2006 compared to December 2005. This credit expansion was the result of lower interest rates in 2006 compared with 2005, growth in the manufacturing and service sectors, and the expansion of the private banking system. However, a large amount of foreign currency, especially US dollars, was sent to respective countries, since many major investors are foreigners and Cambodia's banking system is inadequate. These trends are expected to carry over into 2007, but at a slightly slower pace.

#### 3.4. Interest Rates

According to the National Bank of Cambodia (NBC), the average nominal interest rate on 12-month deposits in riel was 6.8 percent in October, which was the same as in December 2005. However, the nominal interest rate for loans in riel increased sharply, from 18.6 percent in December 2005 to 23.1 percent in October 2006, due to increasing demand for credit and economic activity. The uncertainty and high risks associated with lending were also undoubtedly factors. Lending rates were more than 10 percent above deposit rates. Interest rates in riel were higher than for US dollars, mainly due to depreciation risks and the lack of riel loan credits.

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

|  | 2002 | 2003 | 2004 | 2005 | 2006* |
|--|------|------|------|------|-------|
| Riel 12-month Deposit Rate             | 7.2  | 7    | 6.6  | 6.8  | 6.4   |
| US\$ 12-month Deposit Rate             | 4.2  | 4.0  | 3.7  | 4.0  | 4.8   |
| Riel 12-month Lending Rate             | 21   | 21.1 | 18.7 | 18.6 | 23.1  |
| US\$ 12-month Lending Rate             | 18.2 | 17.3 | 16.7 | 16.2 | 16.7  |
|  |      |      |      |      |       |
| Inflation rate (year on year, in riel) | 0.0  | 1.2  | 3.9  | 5.6  | 4.7   |
| Inflation rate (year on year, in US\$) | 0.1  | -0.1 | 2.8  | 3.6  | 4.1   |

Sources: NBC and NIS.

The higher figure shown in the table reflects the revised methods used by the NBC.

With gradually rising confidence in the financial system and economic expansion over the last decade, both deposit and lending rates decreased slightly on a regular basis. A stable riel and low inflation rate could also, to a certain extent, be responsible for reducing interest rates on loans, by lowering funding costs, and the gap between real and nominal interest rates. However, interest rates were still high, because of a shortage of local deposits required to satisfy a strong demand for credit (resulting from economic expansion), and owing to the high risk of lending. The informality of businesses, the lack of infrastructure or a legal framework, and poor law enforcement are factors behind this high level of risk and uncertainty, which forces banks to charge higher rates.

In addition, to avoid the high risk of unpaid loans, a large amount of local deposits have gone overseas, and are therefore unavailable for lending to local borrowers. In construct, most of credits for local borrowers come from overseas. Thus, most Cambodians have limited access to credit, and annual interest rates on loans or deposits in riel and US dollars are quite high compared to neighboring countries. Cambodians, particularly those in rural areas, are mostly short of initial capital and unable to benefit from economic growth. Lower interest rates would encourage them to invest, thereby contributing towards economic growth in rural areas.

<sup>\*</sup> The interest rate for both lending and deposit in 2006 was relatively the same as 2005.

# Fiscal Development and External Debt

In recent years, the Government has made significant improvements in the implementation of the plans contained in its annual state budgets. The amount of Government revenue has increased by about 20 percent a year. However, this amount has remained relatively flat and weak compared to the level of nominal GDP, as well as that of Government expenditure. The deficit will be mainly financed by foreign assistance, of which external loans account for about 45 percent. Cambodia's debt situation remains on a sustainable path, but the current risk of debt distress is high.

#### 4.1. Budget Revenue

For the last few years, the Government has made significant progress in terms of collecting the state revenue that it had planned. In 2006, Government revenue (excluding MDRI from the IMF of about CR 341 billion) reached CR 2,918 billion, about 11 percent more than in 2005 and 3 percent higher than the planned budget. The main source of state income in 2006 was taxation, which represented about 78 percent of total domestic revenue, whereas other sources of state income, non-tax revenues, only accounted for around 22 percent.

Despite the progress of the Government in collecting the state revenue that it had planned, the amount of revenue collected has remained relatively steady compared to the level of nominal GDP, at on average about 10 percent for the last few years. This rigidity was the reason why the economic growth rate realized during the period was much higher than that expected by the Government in the planned budget. For 2006, the economic growth rate expected in the planned budget of 2006 was only 7 percent, more than 3 percent lower than that realized during the period. Thus, the state revenue in 2006 was only 9.9 percent of the nominal GDP, slightly down from 10.3 percent in 2005.

For 2007, the Government has planned to raise its revenue to CR 3,282 billion, a 12 percent increase on 2006. The main source of that revenue will remain taxation, which is expected to account for about CR 2,682 billion, representing around 82 percent of total revenue, and 18 percent more than was received in 2006. Given the projected strong performance of the economy for 2007, and the Government's recent record in

terms of collecting state revenue, this target may well be reachable. Total state revenue for 2007 is expected to rise by about 15 percent compared to 2006.

Table 4.1: Cambodia's Government Revenue (Billions of Riel)

|                                     | 2002  | 2003  | 2004  | 2005  | 2006  | 2007p |
|-------------------------------------|-------|-------|-------|-------|-------|-------|
| Total Domestic Revenue (1)          | 1,762 | 1,765 | 2,127 | 2,626 | 2,918 | 3,286 |
| Tax Revenue                         | 1,249 | 1,220 | 1,577 | 1,911 | 2,271 | 2,605 |
| Profit Taxes                        | 97    | 110   | 117   | 172   | 262   | 303   |
| Excise Taxes                        | 210   | 198   | 304   | 380   | 418   | 463   |
| Value Added Taxes                   | 452   | 460   | 598   | 730   | 870   | 1,012 |
| International Trade Taxes           | 424   | 395   | 513   | 573   | 645   | 743   |
| Other Tax Revenue                   | 66    | 57    | 44    | 56    | 76    | 84    |
| Non-tax Revenue                     | 513   | 545   | 549   | 715   | 647   | 681   |
| Tourism Activity (2)                | 93    | 83    | 118   | 160   | 190   | 224   |
| Quota Auctions & Export<br>Licenses | 106   | 146   | 76    | 123   | 123   | 123   |
| Post & Telecommunications           | 121   | 120   | 94    | 123   | 83    | 94    |
| Other Non-tax Revenue (1)           | 192   | 196   | 261   | 310   | 251   | 240   |
| Memorandum Items                    |       |       |       |       |       |       |
| Taxes From Petroleum Products       | 377   | 445   | 442   | 460   | 522   | 580   |
| Tax Department Revenue              | 298   | 345   | 405   | 556   | 727   | 860   |
| Customs Department Revenue          | 952   | 875   | 1,173 | 1,355 | 1,544 | 1,744 |

Sources: MEF for 2001-2006, and EIC for 2007.

However, it will remain low as a proportion of 2007's projected GDP, at around 10 percent. To improve revenue collection, more effective measures must be taken to enforce the Law on Taxation, extend the tax base to the informal sector, and especially, strengthen the tax audit in order to reduce revenues lost through corruption. Furthermore, anti-smuggling measures should be strengthened at each border checkpoint, since large-scale smuggling continues, especially of petroleum, due to the high level of tax imposed in Cambodia compared to neighboring countries.

#### 4.2. Budget Expenditure

Regarding expenditure, the Government has also made significant progress in implementing its state budget disbursement plans. In 2006, actual Government expenditure increased sharply by 29 percent and reached CR 4,112 billion, representing around 11 percent higher than what had been planned. As a share of GDP, it recovered to about 14

<sup>(1)</sup> Including Capital Revenue, but excluding MDRI of CR 341 billion from IMF.

<sup>(2)</sup> Including Tourism Income, Civil Aviation and Visa Fees.

percent in 2006 from 12.5 percent in 2005. On average, spending on civil administration rose by 37 percent, while that on defense and security increased by just 15 percent, 7 percent more than 2005's increase. Expenditure on priority sectors also rose significantly by 23 percent compared to 12 percent in 2005, but as a share of GDP was relatively stable at about 2.7 percent.

For 2007, the Government expects to expand its budget expenditure to about CR 4,622 billion, which represents an approximately 12 percent bigger expansion than 2006's. Compared to 2005's expenditure, civil administration disbursement would increase at the same pace by 12 percent, while that for defense and security would fall by 3 percent. This is because the Government plans to reduce defense and security spending and increase the budgets of priority sectors such as health, education, agriculture, and rural development. The disbursement for priority sectors is expected to be about CR 980 billion, a 24 percent increase on 2006.

Table 4.2: Cambodia's Government Expenditure (Billions of Riel)

|                              | 2002  | 2003  | 2004  | 2005  | 2006  | 2007p |
|------------------------------|-------|-------|-------|-------|-------|-------|
| Total Expenditure            | 2,770 | 2,757 | 2,962 | 3,182 | 4,112 | 4,705 |
| Current Expenditure          | 1,579 | 1,586 | 1,769 | 1,967 | 2,592 | 2,956 |
| Civil Administration         | 1,192 | 1,175 | 1,346 | 1,516 | 2,072 | 2,368 |
| Priority Sectors             | 512   | 529   | 573   | 644   | 791   | 921   |
| Other Civil Ministries       | 680   | 646   | 773   | 872   | 1,281 | 1,448 |
| Defense & Security           | 387   | 411   | 423   | 451   | 520   | 588   |
| Defense                      | 245   | 270   | 272   | 289   | 344   | 381   |
| Security                     | 142   | 141   | 151   | 162   | 176   | 208   |
| Capital Expenditure          | 1,191 | 1,171 | 1,193 | 1,215 | 1,520 | 1,749 |
| Through National Treasury    | 288   | 333   | 296   | 315   | 379   | 412   |
| Externally Financed Directly | 903   | 838   | 896   | 900   | 1,141 | 1,337 |
| Memorandum Items             |       |       |       |       |       |       |
| Wages                        | 586   | 615   | 640   | 711   | 822   | 911   |
| Non-Wages Operating Costs    | 993   | 971   | 1,130 | 1,256 | 1,770 | 2,046 |

Sources: MEF for 2002-2006, and EIC for 2007.

Total expenditure for 2007 is expected to reach the Government's target, due to better revenue collection performance. Budget disbursement on priority sectors may reach 2.8 percent of GDP, and expenditure on wages will increase slightly. However, the degree to which the public may

benefit from this additional spending could remain limited, since expenditure, particularly on soft and hard infrastructure, as well as irrigation for the agricultural sector, is unlikely to be sufficient for Cambodian needs. The agricultural sector still largely depends on weather conditions, thus the budget expenditure policy will probably achieve little in terms of poverty reduction.

#### 4.3. Budget Financing and External Debt

2006's budget revenue was low compared to its expenditure. The deficit expanded to about CR1,194 billion, around 32 percent more than was planned in the budget law, and over double 2005's deficit. This was bankrolled mainly through foreign financing (amounting to about CR 1,584 billion, of which half was grants and half was loans), since Cambodia is trying to avoid domestic debt financing. As with 2006, 2007's deficit is expected to increase (this time by about 19 percent), and to be underwritten mainly through foreign financing, of which 68 percent will be loans.

Table 4.3: Financing Cambodia's Budget (Billions of Riel)

|                                       | 2002    | 2003  | 2004  | 2005  | 2006    | 2007p   |
|---------------------------------------|---------|-------|-------|-------|---------|---------|
| <b>Total Domestic Revenue</b>         | 1,762   | 1,765 | 2,127 | 2,626 | 2,918   | 3,302   |
| Total Expenditure                     | 2,770   | 2,757 | 2,962 | 3,182 | 4,112   | 4,725   |
| Total Deficit (cash basis)            | (1,008) | (992) | (835) | (556) | (1,194) | (1,423) |
| Foreign Financing                     | 1,074   | 886   | 894   | 984   | 1,584   | 1,423   |
| Grants                                | 451     | 382   | 372   | 538   | 790     | 461     |
| Loans (net)                           | 622     | 504   | 522   | 446   | 794     | 962     |
| Domestic Financing                    | (65)    | 106   | (59)  | (428) | (390)   | 0       |
| Banks                                 | (104)   | (3)   | 25    | (199) | (333)   | -       |
| Others                                | 38      | 109   | (84)  | (229) | (57)    | -       |
| Memorandum Items                      |         |       |       |       |         |         |
| Net Foreign Reserves at National Bank | 2,267   | 2,536 | 2,840 | 3,336 | 4,076   | 4,694   |

**Sources:** *MEF for 2002-2006, and EIC for 2007.* 

Regarding Cambodia's external debt, 2006's data is not yet available. By the end of 2005 the national debt stood at US\$3.4 billion, of which US\$3.2 billion was external. About 36 percent of the external debt was owed to multilateral sources, mainly the Asian Development Bank, International Monetary Fund and World Bank. Almost 60 percent was owed to the Russian Federation and United States. Cambodia's debt situation remains on a sustainable path, but the current risk of debt

distress is high. This risk would be moderate if debt-rescheduling agreements were reached, especially agreements with the two creditor nations mentioned above.<sup>5</sup>

<sup>&</sup>lt;sup>5</sup> International Monetary Fund, Cambodia: 2006 Article IV Consultation - Staff Report, July 2006.

# Labor Force, Incomes and Poverty

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

Based on the latest data from the Cambodia Socio Economic Survey (2004), the total labor force was about 7.5 million in 2004 or 56 percent of the total population. The country also enjoys a high rate of employment, averaging 95 percent of total labor force during 1994 and 2004.

In the case of Cambodia, it is important to understand the nature of its underemployment problem, in order to have a better and clearer picture of the employment and labor force situation. A simple piece of evidence that supports the importance of comprehending the underemployment situation is that respondents, in a household or labor force survey, tend to answer that they are a farmer, petty trader or petty street seller, etc. However, these jobs are usually unproductive and informal in nature, and do not require full- time work. For instance, a farmer in Cambodia is typically under-employed because his job does not entail full-time employment throughout the year. Farming depends strongly on rainfall. This means that in many places only one harvest is possible, which requires only around half a year of work. During the remaining time they may engage in casual work, as agricultural laborers or small traders; this is a consequence of their underemployment.

Unfortunately, estimates of the underemployment rate have not always been available in time series data. The most recent attempt to estimate the level of underemployment was in 2001, when the National Institute of Statistics conducted the Labor Force Survey (LFS). According to LFS (2001), the country's underemployment rates were 38 percent in 2001 and 28 percent in 2000. It is widely believed that this rate has probably not decreased, since patterns of growth have been sourced from small, formal and urban-based sub-sectors of the garment and construction sectors and to a lesser degree from the spill-over effects of the tourism industry.

The employment structure within the three main sectors of the economy has not changed significantly (figure 5.1). The agricultural sector (including fisheries and forestry) remained dominant, with a 71 percent share of the national employment market in 2004, a decrease of 5 percent since 1993. Services' share remained unchanged from 1993 to 2004, at 17 percent. Employment in the industrial sector increased significantly, its share rising by 5 percent over the decade, from 6 percent in 1993 to 11

percent in 2004. The rise in industrial employment was due to the growth of jobs in manufacturing, especially in the garment industry and construction. Manufacturing's share of total employment increased from just 4 percent in 1993 to 8 percent in 2004, while construction went up from 2 to 3 percent.

An employment shift from agriculture to other industries was noted during the last ten years, especially to formal sectors such as garments and informal sectors like construction. The garment and construction industries require low-skilled and unskilled workers, which makes it easy for rural people to move into them. The share of women employed in agriculture declined significantly from 71.1 percent in 1999 to 56.8 percent of total women employed in 2004, according to household surveys in those years. This declining share was largely attributed to the movement of rural women to the garment industry.

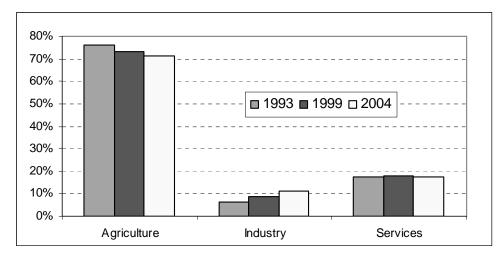


Figure 5.1: Structure of Employment (1993-2004)

Source: EIC GEM, version 2006-05-17 (2006).

#### 5.2. Incomes

The lack of a nationwide regular wage survey prevents any attempt to examine the picture on income for the whole of Cambodia or region by region. However, the regular daily earning surveys conducted by the Cambodian Development Research Institute provide a perspective on wage evolution for a number of vulnerable workers.

Figure 5.1 depicts the daily earnings of vulnerable workers between August 2005 and August 2006. In real terms, the daily earnings of all vulnerable workers declined, except those of garment workers and rice-field workers, whose daily wages increased extremely incrementally. Cyclo and motorcycle-taxi drivers appeared to suffer most seriously, their earnings declining by over 20

percent, followed by porters and small vegetable sellers, whose daily earnings fell by over 10 percent.

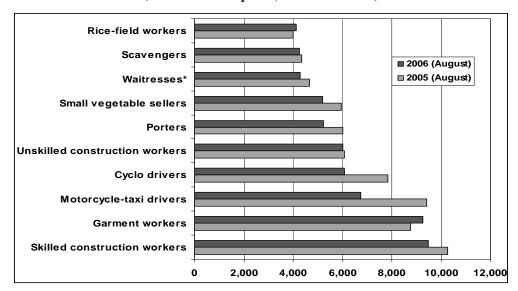


Figure 5.2: Average Daily Earnings of Vulnerable Workers in Real Terms (November 2000 prices, Cambodian Riel)

Source: CDRI, Cambodia Development Review, Vol.10, Issue 4, October-December 2006.

\* Waitresses' earnings do not include meals and accommodation provided by shop owners.

In general, the declining daily earnings of vulnerable workers are the result of increasing numbers of individuals entering these groups. For example, an increase in the number of cyclo and motorcycle-taxi drivers has been noted. Additionally, tuk-tuks have cut into the market shares of cyclo and motorcycle-taxi drivers, helped by the fact that they are an innovation in Cambodia and appear safer and more comfortable.

#### 5.3. Poverty

With high economic growth during the last decade, the poverty rate has been reduced from 47 percent in 1993/1994 to 35 percent in 2004. The number of absolute poor declined from about 5 million to 4.7 million during the same period. On average, poverty declined by about one percent per annum. This poverty reduction pace is slower than that of Lao PDR or Vietnam, which achieve on average 1.3 and 3.2 percent reductions per annum respectively.

A recent report published by UNDP Regional Colombo Centre (RCC) compared the performance of poverty reduction in selected Asian countries. The report concluded that Cambodian income growth was rapid, but not robust. Poverty reduction in Cambodia was judged to be slow. This conclusion was the same as in the cases of India and Sri Lanka.

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<sup>&</sup>lt;sup>6</sup> Based on the "Demographic Estimates and Revised Population Projections", last version, June 2005.

**Table 5.1: Performance of Poverty Reduction in Selected Countries** 

| Country     | Income Growth                                     | Inequality                | Poverty Reduction                      |
|-------------|---|---------------------------|--|
| Cambodia    | Rapid but not robust                              | High & Rising             | Slow                                   |
| China       | Very rapid  | High & Rising             | Rapid, but less than potential rate    |
| Indonesia   | Rapid before 1997, slow since 2000                | Low                       | Rapid until 1997, slow in recent years |
| Malaysia    | Rapid, some slowdown after 1997                   | High, but fallen a little | Rapid, except between 1997 and 1999    |
| Philippines | Slow  | High & Rising             | Slow, if at all                        |
| Thailand    | Rapid until 1997, slow recently                   | High, rose until recently | Fairly rapid, less than potential      |
| India       | Moderate in the 1980s,<br>rapid since early 1990s | Moderate but rising       | Slow                                   |
| Sri Lanka   | Modest  | Moderate but rising       | Slow                                   |

**Source:** Extract from table 1, Asian Experience on Growth, Employment and Poverty Reduction (2007), UNDP RCC.

Inequality has been high and rising. This was also found to be true in other countries; for example, China. Estimates of the Gini coefficient, with geographically comparable areas, increased from 0.347 in 1993 to 0.403 in 2004, primarily driven by increased inequality within rural regions. Deeper analysis showed that 86 percent of the total increase in inequality was attributable to its rise within rural regions and only 14 percent to a rural-urban rise in inequality.<sup>7</sup>

In terms of the distribution of the poor, it is the rural areas which play host to the vast majority. Table 5.2 indicates that 92 percent of the poor are currently concentrated in rural regions. Districts adjacent to the Tonle Sap, where people depend largely on fresh fish resources, along with plateau and mountainous zones, where the locals rely mainly on forest resources, are the poorest regions of all, with poverty headcounts of 45 percent and 56 percent respectively. Rural Tonle Sap and rural plateau/mountain have the worst poverty indexes, averaging 1.5 times and twice the national average, respectively.

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<sup>&</sup>lt;sup>7</sup> The World Bank, "Halving Poverty by 2015? Poverty Assessment 2006".

**Table 5.2: Distribution of the Poor by Zones** 

| Zones            | Poverty Headcount Index | Distribution of Poor (% of all poor) |
|------------------|-------------------------|--------------------------------------|
| Phnom Penh       | 4.60                    | 1.10                                 |
| Urban            | 1.11                    | 0.20                                 |
| Rural            | 8.92                    | 1.00                                 |
| Plains           | 32.07                   | 39.70                                |
| Urban            | 13.74                   | 0.70                                 |
| Rural            | 32.86                   | 39.00                                |
| Tonle Sap        | 42.80                   | 37.00                                |
| Urban            | 28.21                   | 3.70                                 |
| Rural            | 45.38                   | 33.40                                |
| Coastal          | 26.84                   | 6.10                                 |
| Urban            | 20.41                   | 1.60                                 |
| Rural            | 30.07                   | 4.60                                 |
| Plateau/mountain | 52.02                   | 16.10                                |
| Urban            | 32.61                   | 1.80                                 |
| Rural            | 56.34                   | 14.20                                |
| Cambodia         | 34.68                   | 100.00                               |
| Urban            | 17.62                   | 7.90                                 |
| Rural            | 37.82                   | 92.10                                |

**Source:** The World Bank, "Halving Poverty by 2015? Poverty Assessment 2006".

# Part II

# STRUCTURAL REFORMS: CURRENT IMPLEMENTATION AND PROSPECTS

### Banking and Financial Sector Reform

A healthy banking and financial sector is an important precondition, if not a prerequisite, for sustaining economic growth. To develop a healthy and vibrant financial sector, the Royal Government of Cambodia has been conducting reforms in line with the Financial Sector Blueprint 2001-2010. Recently, the Council of Ministers approved a new Financial Sector Development Strategy 2006-2015 on 9 February 2007. The result of these reforms should be the establishment of a robust financial sector.

#### 6.1. Banking

The first semester of 2006 was marked by numerous activities initiated by the National Bank of Cambodia (NBC). From on-site and off-site inspection to regulating steps, from the reporting obligations of private banks to bank licensing, the banking sector has seen many changes.

Another important achievement was the issuance of the Prakas on Credit Information Sharing (CIS) in June 2006. The CIS system will allow bank members to share, through a website, negative information about their clients' credit status. The CIS was officially launched on 09 September 2006 with the creation of the special website. A code of conduct, regulating information collection, management and misuse, was signed by the 18 member banks. The CIS is not applicable to microfinance institutions, since their services targeted uniquely at poor people.

Nevertheless, many questions have been raised. These relate to whether the CIS conforms to the Constitution, especially in terms of customer privacy protection, which it guarantees. The main concerns were related to the nature of credit information to be shared, and penalties to be applied in cases where customers' credit information has been misused. Even though CIS is very useful in order for banks to evaluate effectively the financial status of their customers and may in turn help some of those customers to avoid becoming even more in debt, the Prakas's legitimacy is still questionable, since it allows banks to share their clients' personal information. Normally, Prakas are used for implementing or clarifying laws. Which law does the NBC's Prakas implement or clarify? It does not appear to have been issued in accordance with any law.

In order to fulfill its supervisory role, the NBC, through its 13 September 2006 Prakas, requires commercial and specialized banks to submit daily, weekly, monthly, quarterly and annual reports, as well as

reports on reserve requirements and published annual audits of financial statements. Non-compliance may be punishable with a fine. In addition, even if commercial and specialized banks are in possession of permanent licenses, NBC's control remains steady and strict. Specialized banks have to deposit 5% of their registered capital accounts with the NBC, for which they receive interest in return<sup>8</sup>. The rate varies depending on whether the money deposited is in riels or US dollars. This provision has two main purposes: so that the NBC can control the amount of capital held by microfinance institutions, and at the same time, refinance the specialized banks, through interest.

In addition, on 13 September 2006, the NBC issued a new Prakas related to increasing the capital of banks and financial institutions. From September 2006, prior authorization is required from the NBC for any increase in a bank's capital. The fee for this operation is charged at 0.03% of the increased amount. It should be noted that capital plays an important role in increasing customer confidence. A financial institution's capital informs the customer whether or not it has the ability to deal with any financial problems the client might face. This highlights the relevance of the new Prakas, which gives the NBC an important role in monitoring the increase of capital of any financial institution.

Table 6.1: Achievements in the First and Second Semester of 2006 in Banking Sector Reform

| Field                            | Achievements  |  |
|----------------------------------|---|--|
| Supervision & Regulation         | <ul> <li>Law on Amendments to Articles 14 and 57 of the Law on the Organization and Functioning of the National Bank of Cambodia (NBC) promulgated on 29 December 2006</li> <li>Launched CIS website (facilitate banking operations)</li> <li>Prakas on amendment to Prakas on Licensing of commercial bank 13 September 2006</li> <li>Prakas on amendment to Prakas on Licensing of specialized bank 13 September 2006</li> <li>Prakas on amendment to Prakas on fee for increase of capital of banks and financial institutions 13 September 2006</li> <li>Finalized Financial Sector Development Strategy 2006-2015, approved by CoM on 9 February 2007</li> <li>Drafted Law on Money Laundering and Combating Terrorism Financing awaiting adoption at the National Assembly</li> </ul> |  |
| Banking Industry and Competition | Finalize Drafting of Leasing Law  |  |

**Source:** Royal Gazette and interview with the NBC officials.

During the second semester of 2006 (on 29 December), the Law on Amendments to Articles 14 and 57 of the Law on the Organization and

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<sup>&</sup>lt;sup>8</sup> Prakas on amendment to Prakas on Licensing of commercial bank of 13 September 2006 and Prakas on amendment to Prakas on Licensing of specialized bank of 13 September 2006.

Functioning of the National Bank of Cambodia (NBC) was promulgated. The amendments focus on restructuring the NBC board members' qualities and functions. Under the amended Article 57, the financial records of the Central Bank shall be verified by the Board of Directors of the National Bank of Cambodia and the National Audit Authority. The conditions relate to age, accumulation of function, criminal record etc.

There has been growth in non-banking financial services such as leasing. Currently, drafted leasing is sent to the Council of Ministers and waits for its approval. At the same time, many initiatives are making slow progress. The Prakas on reserve requirements which was drafted in the first semester of 2006 has not been released yet. The draft Law on Money Laundering and Combating Terrorism Financing which was passed by the Council of Ministers has never been adopted by the National Assembly.

As for banking operations facilitation, during the 11<sup>th</sup> Government-Private Sector Forum held on 24 January 2007, the President of the Services Including Banking and Finance Working Group identified many problems as major obstacles for banking and micro-financing operations. Those problems ranged from the withholding tax on international loans, the management of the distribution of land ownership, as well as contract and land title enforcement

Interest rates remained steady compared to the first semester of 2006. For loans in US dollars interest rates varied between 13.8 percent and 16.5 percent, depending on the length of the loan. Interest rates were from 18.6 percent to 21.2 percent for loans in riel. As for deposits in US dollars, interest rates varied between 2.5 percent and 4.41 percent for fixed accounts and 1.1 percent for savings accounts. If deposits were made in riel, interest rates were a little bit higher than for US dollars, and ranged between 4.8 percent and 6.7 percent for fixed accounts and 2.1 percent for savings accounts.

Table 6.2: Interest Rates during the Last Trimester of 2006

| Type of operation | Average                             |  |  |
|-------------------|-------------------------------------|--|--|
|                   | USD                                 | Riel                                   | Other Currency                         |
| Loan              | 13.8%-16.5%                         | 18.6%-21.2%                            | 17.3%-18%                              |
| Deposit           | 2.5%-4.4% (Fixed) and 1.1% (Saving) | 4.8%-6.7% (Fixed)<br>and 2.1% (Saving) | 2.2%-3.4% (Fixed)<br>and 2.2% (Saving) |

Source: National Bank of Cambodia September-December 2006.

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<sup>&</sup>lt;sup>9</sup> National Bank of Cambodia Review, 4<sup>th</sup> Trimester of 2006.

By the end of 2006, with the Negotiable Instruments and Payment Transaction Law, financial activities have been more and more facilitated. The NBC has issued many regulations in order to strengthen its supervisory role on both commercial and specialized banks. Some measures had not yet been taken for banks to undertake credit card services, housing and mortgage finance, installment finance, etc.

#### 6.2. Rural Finance

Rural finance as becoming an increasingly important topic for the Government as it attempts to establish sustainable economic development and reduce the rate of poverty. The Government, on 11 January 2006, announced 2006 as a "Year of Microfinance".

Like private banks, MFIs are subject to licensing procedures and have an obligation to provide reports to the NBC. MFIs may be fined if their reporting obligations are not performed accordingly. A new Prakas amending the Prakas on Licensing of Microfinance Institutions, issued on 13 September 2006, established an advantageous new rule for microfinance institutions. Once a license has been awarded, it is indefinite. This provision helps microfinance institutions to be less subject to external administration.

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

| Progress  | Remaining Issues   |
|---|--|
| <ul> <li>Indefinite license is provided to MFI</li> <li>As of the end of 2006 number of licensed MFIs is 16</li> <li>As of the end of 2006, number of registered NGOs was 23</li> <li>Finalized new financial sector development strategy 2006-2015, waiting for approval of CoM</li> </ul> | <ul> <li>Regulations to protect depositors have not yet developed.</li> <li>Registration of all rural credit operators is not yet completed</li> <li>Full on-site inspection on all licensed MFIs and registered NGOs</li> <li>Encouragement of commercial banks to engage in rural credit operations</li> <li>Leasing and crop insurance is not introduced yet</li> </ul> |

Sources: NBC Quarterly Report- fourth trimester 2006 and compiled from various sources.

However, even though licenses are indefinite, this does not mean that microfinance institutions are totally outside the control of NBC. This control is demonstrated by the fact that microfinance institutions have to pay a sum of 100,000 riels for each page of the Article of Association they amend. In order to ensure the NBC retains its monitoring role, the same Prakas

requires the microfinance institutions to maintain 5% of their registered capital in permanent accounts with the NBC. In return, the microfinance institutions will receive interest, paid semi-annually by the NBC.

In terms of encouraging the registration of new MFIs, their number increased from 16 to 23 between 2005 and the end of 2006. Overall, registration remained steady.

Even though the number of depositors is very high, there are no regulations protecting them. Moreover, Cambodia is currently still applying the Contract Law (from 1988) with regard to mortgages. This law is not detailed enough, and is applied equally to rich and poor people alike. There is a strong need for a new law dealing with the specific problems suffered by poor people. Such a law would provide greater incentives for farmers to seek access to microfinance, for example by protecting their land from confiscation, and would conform to the Blueprint policy.

Overall, little improvement has been made concerning the country's rural finance sector reform. The core reform focuses especially on strengthening the supervisory role of the NBC on the microfinance institutions. Even though steady progress has been seen in the field of supervision, many of the activities outlined in the Blueprint have not been completed. Progress has been very slow in the promotion of deposits and the transformation of merged/restructured banks into licensed MFIs, as well as in deepening the linkages between MFIs and banks.

# **Public Financial Management**

The public finance sector is dominated by the Public Financial Management Reform Program (PFMRP) which was adopted in 2004. Progress remains slow for some of the activities enacted in the PFMRP. At the same time, as the financial year drew to a close, the last trimester of 2006 was marked by the Budget Law 2007 and many regulations for its implementation

#### 7.1. Budget Law 2007

Table 7.1: New classification of State Revenue and Expenditure

| Article 6 State resources                                   | New article 6 State resources                              |
|---|--|
| - Category 1: Tax and Customs                               | - Current revenue  |
| - Category 2: Non-tax revenue                               | . Group1: Current Revenue                                  |
| - Category 3: Capital Revenue                               | Category 1: Tax revenue                                    |
|   | Category 2 Non-tax revenue                                 |
|   | . Group 2: Revenue on order                                |
|   | Category 3: Revenue on order                               |
|   | - Revenue in capital                                       |
|   | . Group 1: Current revenue                                 |
|   | Category 1: Direct revenue                                 |
|   | Category 2: Revenue from abroad                            |
|   | . Group 2: Revenue on order                                |
|   | Category 3: Revenue on order                               |
| Article 14 Current expenditure                              | New article 14 Current expenditure                         |
| Category 1: Debt servicing                                  | - Group 1: Current expenditure                             |
| Category 2: Loan interest                                   | . Category 1: Debt servicing                               |
| Category 3: Public  | . Category 2: Financial expenses                           |
| intervention  | . Category 3: Public intervention                          |
| Category 4: Miscellaneous                                   | . Category 4: Miscellaneous expenditure                    |
| expenditure   | - Group 2: Expenditure on order and unforeseen expenditure |
|   | . Category 5: Expenditure on order                         |
|   | . Category 6: Unforeseen expenditure                       |
|   | New article 15 Capital expenditure                         |
|   | - Group 1: Current expenditure                             |
|   | . Category 1: Loan reimbursement                           |
| Article 15 Capital expenditure                              | . Category 2: Capital expenditure                          |
| Category 5: Construction,                                   | - Group 2: Expenditure on order                            |
| Equipment, Financial<br>transactions, Debt<br>reimbursement | . Category 3: Expenditure on order                         |

Source: Budget Law 2007.

The Budget Law 2007 was promulgated on 29 December 2006. The law marks a new milestone for public financial management. It applies many

amendments to the so-called Law on Financial Systems, adopted in 1993 and modified by the Law on Finance Management 1995. As a result, 12 articles have been changed.

Reform has focused particularly on reclassifying and restructuring State revenue and expenditure. As a result, only tax on goods, services and external trade is now considered tax revenue. Tax on State heritage, money from the sale or hire of property or services, fines, grants, donations, financial instruments and special products are all classified as non-tax revenue. Loans, grants, subsidies and financial credits are considered capital revenue.

The new classification system intends to facilitate a broad band of State financial operations. Each group and each category falls under a different legal statute. For example, the Budget law 2007 prescribes that any expenditure falling under category two and category six of the Current Expenditure (see Table 7.1 right) may be used specifically for paying off interest, or for capital or restitution purposes.

Table 7.2: New Calendar for MEF to Prepare National Budget

| March - May          | <ul> <li>□ Prepare new macroeconomic policy and medium term public finance framework coherent with the national policy on development for approval of the Council of Ministers (first week of March);</li> <li>□ Issue circular on how to prepare strategic budget plan in accordance with the previously mentioned macroeconomic policy and medium term public finance framework (first week of April);</li> <li>□ Ministers, Directors of independent State institutions and Governors of municipalities and provinces to prepare strategic plans for own budgets.</li> </ul> |
|----------------------|---|
| June-September       | <ul> <li>□ Draft circular on how to prepare budget which must be adopted by the Council of Ministers (first week of June);</li> <li>□ Ministers, Directors of independent State institutions and Governors of municipalities and provinces provide details on their revenue and expenditure and send it to MEF;</li> <li>□ Discussion with Ministers, Directors of independent State institutions and Governors of municipalities and provinces on their proposals (August);</li> <li>□ Finalize balance of revenue and expenditure (September).</li> </ul>                     |
| October-<br>December | <ul> <li>□ Draft financial law for the Management of the year is submitted to the Council of Ministers (first week of October);</li> <li>□ Submit draft law to National Assembly (first week of November);</li> <li>□ Submit draft law to Senate (first week of December).</li> </ul>   |

Source: Budget Law 2007.

In order to implement the new classification of State revenue and expenditure, MEF issued a series of two Prakas, creating a common accounting

table for State (dated 16 January 2007), province and municipality (dated 29 December 2006). However, it is unclear how long it will be until officials are familiar with the new accounting table; this will require thorough training, as it concerns the State budget.

The law establishes a new calendar for budget preparation, which must be processed in three steps: Preparation of strategic plans (from March to May); Preparation of budget (from June to September); and Adoption of budget (from October to December).

The calendar for budget preparation is very clear. On principle, if the financial law cannot be passed, that for the management of the previous year is applicable. This means that the new calendar does not propose a specific timeframe for the Ministers to revise the draft law in case of a negative vote by the National Assembly.

To strengthen the revenue collection for 2007, a Circular (dated 30 December 2006) of the Ministry of Economy and Finance was issued to implement the Financial Management Law 2007. As its main objective, the Government is committed to collecting revenue amounting to 10.92 percent of GDP or 3,400,573 million riel. As a result, many measures are being set up in order to enforce revenue collection. Those measures concern mostly the Customs and Excise Department's role in the collection of tax revenue and other institutions' collection of non-tax revenue.

One of the most remarkable modifications relates to state financial resources. Certain resources belonging to the state will be transferred to the municipalities and provinces. Those resources are as follows:

- **Tax revenue**: Registration tax, Tax on non-utilized land; Tax on street lighting (Tax on wine and cigarettes); Excise on accommodation; Tax on trade operation licenses (Patents); Tax on animal slaughtering and Tax on transport equipments and vehicles.
- Non-tax revenue: Mineral concessions; Renting out of marketplaces; Revenue from market user fees (Phasi or Droit de Place); Parking places revenue; Revenue from boats; Revenue from slaughterhouses; Revenue from ferries; Revenue from auctions; Revenue from water supply authorities and Revenue from electricity supply authorities.

An additional law will determine other tax and non-tax resources of provinces and municipalities. It is not known how or when municipalities or provinces will collect those taxes transferred from the State.

#### 7.2. Current Progress on PFMRP

The Secretariat of the GDCC has reported that 89% of the engaged activities are satisfied. It should be noted that in the PFMRP, there are 254 activities identified as key ways of accelerating financial management reform. The delays concern mainly the Merit Based Pay Initiative (MPBI) that was adopted in 2005 and received 263 participants, and the consolidation of government bank accounts (activity 9 of the PFMRP)<sup>10</sup>. However, progress appears to have slowed down as during the third trimester, only 86% of activities are reported as satisfied<sup>11</sup>.

Overall, many changes have been observed in the area of public financial management. As a consequence, facilitation and rapidity are reflected by the fact that 40% of revenue collection were done through banking system. Moreover, trial on tax payment through ACLEDA has been launched and will extend soon to ANZ Royal. The 2007 Budget Document contains information on spending which is funded by donors.

In the expenditure program area, the Government strengthens internal audits by requiring each ministry to establish an audit department. Currently, 19 ministries have completed this requirement, of which seven are operational<sup>12</sup>.

In the area of expenditure management, there is progress in debt management through the introduction of a new software package for debt management and staff capacity building. In addition to standards regulating procurement and financial management, a draft Debt Management Manual for Department of International Cooperation staff was completed in 2006. Moreover, the State expenditure reform is marked by new pilot of direct payment to senior staff of MEF and MoH<sup>13</sup>.

According to the 10 January 2007 sub-decree, the government has decided to increase the pensions of retired police officers, disabled officials and handicapped veterans by 15 percent.

 International Convention on Mutual Administrative Assistance in Customs Services

The law on the adoption of the International Convention on Mutual Administrative Assistance in Customs Matters was promulgated on December 02, 2006.

<sup>&</sup>lt;sup>10</sup> Overview of TWGs progress, February 2007.

<sup>&</sup>lt;sup>11</sup> Overview of TWGs progress, October 2006.

<sup>12</sup> World Bank.

<sup>13</sup> World Bank.

Currently, the problem of transnational organized crime and terrorist groups is one of the most challenging in international trade management. The international exchange of information, which must be an essential component of any effective risk management strategy, should be based on clear legal provisions. For these reasons, on June 27, 2003, in Brussels, Belgium, the Customs Co-operation Council, known as the World Customs Organization (WCO) initiated the establishment of an international convention aiming to create closer co-operation between Customs Administrations.

#### - The Sub-Decree on Public Procurement

A step towards public financial management reform was marked by a Governmental sub-decree on Public Procurement, dated 18 October 2006. Recently, through a new sub-decree dated 14 February 2007, the government accepts to apply Joint Standard Operating Procedures, Joint Financial Management Manual and Joint Procurement Manual with the World Bank and ADB. Public procurement is considered to be the main source of state expenditure. In the PFMRP, the procurement procedure figures as one of the policies that needs to be reformed and strengthened in order that public expenditure is transparent.

The procurement sub-decree was adopted to ensure the regularity of public expenditure in the procurement field. Its intention is to guarantee that any public procurement is made in obedience to the principles of transparency, equality, and fair competition, as well as the unique rules of procurement. The sub-decree proposes many good provisions to guarantee the scrutiny of procurement. The right to oppose the bidding process, in case of irregularity, is mentioned. In order to ensure those principles, the sub-decree set up administrative penalties (in addition to criminal penalties) dealing with corruption, complicity and coercion.

The sub-decree does not provide a scrutinized procedure on procurement. The Ministry of Economy and Finance (MEF) is in charge of providing more detail on procurement procedures. Currently, there is no ministerial regulation implementing the sub-decree.

The Ministry of Economy and Finance has the unique right to decide on who is going to be the supplier to the concerned Ministry. Each Ministry must establish its own special Committee that is in charge of giving recommendations on potential contracts and monitoring contract applications.

 Sub-decree on Rules and Procedures of Reclassification of Public Property of the State and State-Owned Institutions

Adopted on 27 November 2006, this sub-decree limited the duration of lease contracts of State public property that must not exceed a period of 15 years.

#### 7.3. Law on Government Securities

This law was promulgated on 10 January 2007. The purpose of this law is to provide a framework for the efficient issuance and management of government securities. This will ensure that the Government's financing needs and payment obligations are met at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk, as well as contributing towards the development of a securities market in the Kingdom of Cambodia (Article 1).

The Government will establish a Government Securities Management Fund (GSMF) <sup>14</sup> to effectively manage the issue and redemption of government securities and other related matters. The national audit authority may audit all operations, ranging from security issuance to securities reimbursement. However, the law does not impose a specific date for auditing. Regular, legally required auditing may effectively guarantee resources from securities issuance. The law does not propose specific penalties resulting from any infringements related to securities management.

The law focuses especially on the management and organization of security issuance. However, it does not contain any provisions (such as buyers' rights or a competent tribunal) aimed at building up confidence among the public or facilitating the payment of bills that are due. Interest rates, as well as bill registration and reimbursement methods will be determined by governmental sub-decrees.

In conclusion, even though the progress of the PMFRP was making slow progress during the last semester of 2006, many activities have been initiated since the new financial year began. The Ministry has taken a number of measures aimed at reforming financial management, especially the restructuring and reclassifying of State revenue and expenditure. In parallel, many measures, ranging from Prakas to Circulars have been initiated to facilitate and coordinate the reform of revenue collection.

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<sup>&</sup>lt;sup>14</sup> "Government Securities Management Fund" means money provided by the Government and money received from private and public institutions through issuance of government securities. Such money shall be used for paying the issued securities. The fund is not established for humanitarian purposes (Article 2).

Those measures are aligned with sub-decrees and laws regulating the sources of State expenditure and revenue, such as procurement and government securities.

#### Trade Reform

This chapter will examine the progress of the WTO laws enactment program, economic integration through ASEAN and the implementation of the Twelve Point Plan, which focuses on the improvement of the country's investment climate and trade facilitation. This plan tracks the progress made since March 2006 and assesses future prospects.

#### 8.1. WTO Commitments

One of the main tasks of Cambodia, in its trade reform program, is to enact all necessary laws in order to fully comply with its commitments as a member of the WTO.

In 2006, only five laws were promulgated to fulfill Cambodia's accession commitments to the WTO. In addition, the export-processing zone has been regulated by a sub-decree, rather than a law as was promised to the WTO. It should be noted that to become member of the WTO, Cambodia has engaged to pass 47 essential laws by 2006. Since 2003 only 23 laws have been passed. The prospect of passing all 47 laws by 2008 seems to be distant, as the election period (2007 and 2008) has already begun. It is now crucial that the executive and legislative branches prioritize such acts as the Law Establishing Commercial Courts, the Secured Transactions Law, the Civil Code, the Criminal Code, and the Criminal Procedure Code.

Table 8.1: Legal Instruments Adopted in 2006-2007 to Fulfill Cambodia's Accession Commitments to WTO

- 1. Civil Procedure Code, promulgated on 06 July 2006.
- Law on the issuance and trade of non-government security, promulgated on 10 January 2007.
- Land Traffic Law (Highway Code) waiting for promulgation, adopted on 20 December 2006.
- 4. Fisheries Law, promulgated on 21 May 2006.
- 5. Sub-decree on export-processing zones.

During the last trimester of 2006, the only law related to WTO accession commitment adopted by Parliament was the Land Traffic (Highway) Law. In order to promote internal trade, on 05 January 2007 there was also a new sub-decree on the creation of a Special Economic Zone at

Kampot (Kampot SEZ). Due to a lack of articles in the sub-decree, little is known regarding the structure and the functioning of the Kampot SEZ.

Unfortunately, the draft law on concessions, which was adopted by the Council of Ministers in 2005, has not yet been debated in the National Assembly.

These delays, from drafting to promulgation, were partly due to a shortage of financial and technical resources and capacity, as well as a lack of coordination among government ministries, according to government officials interviewed by the research team. In addition, insufficient parliamentary sessions, holidays and political agendas also impeded the finalization of the laws.

In the trade facilitation area, reform was mainly guided by the Twelve Point Action Plan issued by the Government in 2004 to improve the investment climate and competitiveness. During the 11<sup>th</sup> Government-Private Sector Forum held on 24<sup>th</sup> January 2007, the question of exportation fees and the Single Window Project was raised. The representative of the Export Trade Facilitation Working Group said that the Single Window Project had been delayed or poisoned. The Single Window Project was created with the intention of facilitating trade, by establishing an electronic link via which traders could submit the required import/export documents, as well as paying fees, duties, and taxes<sup>15</sup>. Due to a divergence between the World Bank, the donor for this project, and the Government on the legal status of the agency administering the Single Window, this project has been postponed. In a verbal response, the Prime Minister refused to continue with negotiations on this issue, owing to the fact that Customs privatization affects national sovereignty.

The exportation fee was reduced by just 10 percent, despite the representative of the Export Trade Facilitation Working Group having suggested a 25 percent cut.

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http://go.worldbank.org/WLIBZ03TN0, Consulted on 05 March 2007.

Table 8.2: Status of Remaining Laws for WTO

| 1.  | Law Establishing the Commercial                             | Draft law being discussed between MOC                   |
|-----|---|---|
| 2.  | Civil Code  | Draft law at NA   |
| 3.  | Criminal Code   | Draft law at NA   |
| 4.  | Criminal Procedure Code                                     | Draft law at NA   |
| 5.  | Law on Geographical Indications                             | Draft law being discussed at MOC                        |
| 6.  | Laws on Layout Design of<br>Integrated Circuits             | Draft law at department of industrial techniques, MIME. |
| 7.  | Laws on Plant Variety Protection                            | Draft law at department of industrial techniques, MIME  |
| 8.  | Law on Protection of Undisclosed                            | Working to prepare draft law                            |
| 9.  | Custom Code   | Draft law at NA   |
| 10. | Law on Anti-dumping Measures and on Countervailing Measures | Draft law at CoM awaiting approval                      |
| 11. | Insolvency Law  | Draft law at CoM awaiting approval                      |
| 12. | Secured Transaction Law                                     | Draft law at NA   |
| 13. | Commercial Leasing Law                                      | Draft at MOC  |
| 14. | Water Supply Law  | Draft at CoM awaiting approval                          |
| 15. | Water Resources Management Law                              | Draft Law at NA   |
| 16. | Telecommunication Law                                       | Draft Law at NA   |
| 17. | Tourism and Entertainment Law                               | Draft Law at CoM awaiting approval                      |
| 18. | Civil Aviation Law  | Draft Law at NA   |
| 19. | Merchant Shipping Law                                       | Draft law at MTPW, changed to Maritime Code             |
| 20. | Commercial Contracts Law                                    | Draft law at MOC  |
| 21. | Commercial Agency Law                                       | Draft law at MOC  |
| 22. | Competition Law   | Draft law at MOC  |
| 23. | Law on Safeguard Measures                                   | Draft law at MOC, awaiting technical assistance         |
|     |   |   |

Source: Based on consultation with various government ministries and agencies.

Even if major laws linked to Cambodia's WTO accession commitments were not passed on time, at least 2006 saw some progress in terms of trade facilitation. In the first semester, reforms were introduced which successfully addressed problems encountered by exporters and importers. The time and cost of container shipping for exports and imports was significantly reduced.

Data retrieved from WB/IFC's Doing Business website suggested that in 2006 the time spent processing the eight documents required for export dropped by seven days, while the time spent processing the 12 documents required for import decreased by ten days. Another study by Emerging Markets in 2005 found that the average cost of processing a shipment decreased from US\$942 to US\$598-612, while total average spending per shipment fell from US\$2,477 to US\$673.

Another achievement was the 08 September 2006 Announcement of the Ministry of Commerce, relating to the Implementation of the Plan of Reform of company incorporation and the decentralization of business registration. This marks a new step in trade facilitation as the procedure of registration is not centralized any more.

Efforts to implement the Twelve Point Action Plan reforms have yielded positive results for export and import activities, since time expenditure and costs have been reduced. The Single Window Project should be discussed further, as it is a fundamental pillar of trade facilitation.

#### 8.2. Regional Integration

In terms of regional integration, Cambodia, under the auspices of ASEAN, is actively negotiating free trade agreements with other countries; namely Japan, China, the Republic of Korea, India, the EU, Australia and New Zealand.

Currently, it is not expected that a free trade agreement between ASEAN and Japan can be concluded in March as previously agreed. 5,200 varieties of goods are still subject to negotiation, which has been in progress since 2005. The timeframe for the India-ASEAN agreement is likely to be even longer, as the two parties have encountered many divergences, especially on negative list establishment and the timeframe for sensitive product liberalization. It is expected that an agreement can be reached by June 2007 and implemented by July 2007. Discussions with Australia, New Zealand and Korea will resume in March 2007.

China and ASEAN are moving forward regarding trade liberalization. As a result, complimenting an agreement on goods that has been in force since 2005, a free trade deal on services was signed in Cebu, the Philippines, and will be implemented in July 2007.

Apart from ASEAN-Third countries framework, Cambodia has bilaterally negotiated with some countries. On 2<sup>nd</sup> August 2006, Vietnam has offered duty free on 40 Cambodian agricultural products except tobacco and rice which is under quota regime. Moreover, these two

countries have shown strong commitment on developing trade along border area. This is demonstrated by the opening of 8 new international border checkpoints and 8 national border checkpoints, and a project on establishing 7 special economic zones.

A plan on establishing an economic triangular area was discussed among the leaders of Cambodia, Vietnam and Laos on 5-7 December 2006.

To sum up, it is now crucial that the executive and legislative branches prioritize such laws as the long-awaited Anti-corruption Law, the Law Establishing Commercial Courts, Secured Transaction Law, Insolvency Law, Commercial Contract Law, the Civil Code, and the Criminal Code. Given that government efforts towards deeper regional economic integration, vis-à-vis ASEAN and other Asian partners are progressing well, and that all concerned have expressed their strong will and commitment, the prospects for concluding free trade agreements with third countries are positive.

#### **Public Administration Reforms**

Public administration reform is considered the heart of the Government's Rectangular Strategy, helping to improve good governance, thereby promoting social welfare and strengthening the competitiveness of all sectors. The implementation of a meritocratic system has been given priority at the central level of administration while reform at the subnational levels focuses more on democratic development.

#### 9.1. Central Administration Reforms

So far, overall administration reform at the central level has seen gradual improvement. The Government has put priority on the enhancement of human resource capacity and rising public servant remuneration through the setting up of various strategies and action plans. Some human resources management (HRM) practices such as incentive schemes, capacity building programs, redeployment of the civil service, and enforcement of HRM information systems, have been implemented gradually.

A wide range of training courses and seminars aimed at capacity building has been conducted, through programs such as the Management Development Program (MDP), Professional Development Program (PDP), Economic and Capacity Building Project (EPSCB), etc. This training has focused on raising public servants' knowledge in the field of management and professional development, including development policy, governance and applied economic development.

A meritocratic system has been introduced to encourage both wage reform and human capacity building within government ministries and institutions. Importantly, these reforms result in public servants' remuneration increasing by 15 percent per year. Consequently, the average salary of civil servants has now reached approximately US\$46 per month. Still, this salary is clearly insufficient to cover average living expenses especially for people who live in urban areas where the price of commodities increases from day to day.

In an effort to further improve the employment and pay conditions within the civil service, the Government is now developing a medium term strategy and action plan to enhance remuneration, as well as a redeployment policy and action plan. However, the development of this policy framework has made little progress during the last six months.

Incentive schemes have been implemented through Priority Mission Groups (PMGs) and merit based pay initiatives (MBIs) in some ministries, such as MEF and MOH, and the Government has plans to extend these practices to other ministries. However, the process of establishing PMGs has met with some delays and been held back by weak participation from the relevant ministries. It has been noted that the establishment of PMGs has suffered because of the ignorance of senior Government officials in the relevant ministries, while these programs do not benefit the individuals in charge of them<sup>16</sup>.

PMGs are currently viewed as critical tools in the implementation of the joint Government-Donor Strategy for Phasing Out Salary Supplementation Practice in Cambodia. The implementation of this strategy is now in progress but the process of gathering information on salary supplementation is reportedly behind schedule. Overall, there has been little progress in the implementation of action planning under the strategy, with greater and more timely support being required from all relevant sectors<sup>17</sup>.

Regarding another aspect of reform, the implementation of the One Window Offices (OWOs) policy now requires particular attention from policy makers. It is expected that the OWOs policy will greatly simplify and enhance the service delivery mechanism within public institutions through reducing unnecessary bureaucratic procedures.

In this regard, the Government has prepared a draft sub-decree on OWOs, according to which at least five OWOs will be established across the country. With the support of the French Government, a plan to create a number of OWOs in Phnom Penh and Takeo is ready for implementation. While the sub-decree is reported to be under consultation within the Government, no further action has been observed during the last six months.

Overall, public administration reform at the national level has resulted in some notable achievements. Nevertheless, the public service delivery system could serve people much better. Civil servants' salaries are still not adequate, compared to the cost of living, especially when rising prices are taken into account. Many civil servants are suffering because of their low salaries, forcing them to become involved in unofficial fee payment practices, leaving them demotivated, and resulting in inefficient service delivery. It is estimated that in real terms the average salary of civil

<sup>&</sup>lt;sup>16</sup> Interview with key informants, including the Council for Administrative Reform.

<sup>&</sup>lt;sup>17</sup> Progress report of TWG on Public Administration Reform, January 2007.

servants in 2005 represented only 4.9 percent of the level of remuneration those in similar posts enjoyed in the 1960's<sup>18</sup>.

At this premature stage of reform, the implementation of PMGs appears to be critical, in the sense that it would help improve public service performance where this is demanded as a priority. In this regard, there should be a strong focus on practical guarantees of the transparency and effectiveness of the establishment process of PMGs in each ministry or public institution, to ensure that their selection is made on a solid quality and priority basis.

# 9.2. Sub-national Administration Reform

The Government currently views decentralization and deconcentration (D&D) policies as important reform tools to further develop democratic governance at the sub-national level of administration. In this context, the "D&D" policy can also be referred to as the Democratic Development policy.

Under D&D policies, some levels of managerial decision-making are delegated to newly empowered local authorities, which are directly or indirectly elected by the local population. Through this local empowerment and popular participation, the Government is convinced that D&D policy will help improve service delivery and socio-economic development, thereby meeting the priority needs of each local community and reducing poverty.

Now in its fifth year of implementation, decentralization at the commune level is currently among the most successful reforms in Cambodia. It has made local public authorities and the population increasingly familiar with democratic governance. However, concrete empowerment of local government remains weak regarding managerial and fiscal capacities and functions. This is largely a consequence of an incomplete legal framework for the operational administration of commune offices. Furthermore, the development of laws and regulations governing deconcentrated administration at the district and provincial/municipal levels are far behind schedule. All this leads to uncertainty regarding roles and responsibilities both within and between local public institutions.

With the aim of reforming the current weak system, the Government's reform agenda presently gives high priority to the adoption of an organic law on sub-national democratic development, which will reestablish structures and systems at all levels of territorial administration. The drafting process of the organic law is reportedly behind schedule due

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<sup>&</sup>lt;sup>18</sup> Hor Chamroeun, Civil Service Reform in Cambodia, Economic Review V.3 No.4, EIC, 2006.

to some constraints. According to TWG on D&D, the process has been constrained by greater than expected technical and internal policy complications in the law, which will require time and effort in order to avoid misunderstanding and ambiguity, and to plot correctly the long-term future direction of D&D policy<sup>19</sup>.

As a result, progress has been observed during the last twelve months, following a long period of silence. Comprising five volumes, the first draft of the organic law was completed by late 2006 (the first four volumes in June, the final one in December). The Ministry of Interior has been conducting consultations and an internal review with other Government stakeholders on various aspects of the draft. However, public consultations with non-governmental stakeholders have not yet occurred.

Apart from the overall managerial duties and powers of relevant authorities, which need to be clearly defined, several other important issues are also expected to be adequately addressed within the framework of the upcoming organic law. Importantly, these relate to the improvement of transparency and accountability within local administrative mechanisms, the human resources of local administrations, communes' revenue collection capacities, and popular participation in local decision-making as well as in local development.

In this context, the D&D organic law and upcoming second communal election will provide significant opportunities for the Government to take adequate measures to remove those legal and practical constraints. Inputs from related state institutions and close consultation with civil society would be of great benefit to the legislative process as well as helping to define the next practical steps forward.

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<sup>19</sup> Report of Decentralization and Deconcentration Technical Working Group, Mar. 2006 – Jan. 2007.

# Chapter 10

# Legal and Judicial Reform to Improve Governance

Legal and judicial reforms are among fundamental structural reforms arising from the principal that the Cambodian state should be firmly based upon "the rule of law". The last committed deadline for the completion of a legal framework for trade reform and for fundamental legal and judicial reform was the end of 2006. And yet, the overall reform process remains to be finalized. However, improvements have been made to some important legal instruments during the last six months.

#### 10.1. Overall Achievements

The Government has made significant progress in establishing policies and strategies for legal and judicial reforms. A specialized Council for Legal and Judicial Reform (CLJR) was set up in mid-2002 to initiate, encourage and coordinate the reform process. The Professional Training Center for lawyers and the Royal School of Magistracy were established in 2002, and a pilot, upgraded court was set up in Kandal province, in order to model the best case handling practices. By June 2003, the legal and judicial strategy was completed, followed by an action plan adopted by the Council of Ministers in April 2005.

However, overall progress towards adopting the targeted laws and implementing regulations has generally been behind schedule, as successive delays have occurred. A wide range of laws and regulations for compliance with WTO ordinances remain to be passed, while the Cambodian Government pledged just before WTO accession in 2003 to have adopted all of these laws and regulations by early 2006. According to the Doha Declaration, the adoption of these laws and regulations could be delayed until 2008.

Greater progress has been made during the last six months, with the adoption of two additional WTO related laws, including the Land Traffic Law (Highway Code), on Dec. 20, 2006, and the Government Security Law, on Nov. 30 2006. Up to now, Parliament has ratified and adopted 22 out of 46 laws and regulations for compliance with WTO ordinances.

In addition, three important laws that are conducive to the economic and business environment have recently been promulgated. These texts, all made public in December 2006, include the amendment of the Law on the Organization and Functioning of the National Bank of Cambodia, the Financial Management Law for 2007, and the law ratifying

the International Convention on Mutual Administrative Assistance in Customs Matters.

In particular, great tardiness has been shown over the adoption of eight priority draft laws, which are considered fundamental for justice system and public administration reform and conducive to progress in other reform areas.

## 10.2. Progress on the Fundamental Legal Framework

Referred to as fundamental legal instruments, the eight draft laws consist of the penal code, civil code, penal procedure code, civil procedure code, law on the organization and functioning of the courts, law on the statute of judges and prosecutors, amendment of law on the Supreme Council of Magistracy (SCM) and anti-corruption law.

The first four drafts will form a fundamental basis for all legal arrangements and dispute resolutions throughout the whole of society. The other three will be critical to the reestablishment of the judicial system, while the final one will provide an indispensable legal instrument for promoting good governance in the area of fighting corruption. These legal texts have been put under Joint Government-Donors Monitoring Indicators (JMI) and most of them represent long unfulfilled commitments of the Government, dating back to the Tokyo CG meeting of 2001.

Up to the end of 2006, only the civil procedures code had been adopted by Parliament, leaving the other fundamental drafts seriously behind schedule. Over the last six months, significant progress has been made on some of these. The penal procedures code and the civil code have already been sent to the National Assembly for debate and adoption. Reportedly, the penal procedures code is being reviewed by the legislative commission and is waiting for the next session of the Assembly in March 2007. The penal code is now in its finalization stage at the Ministry of Justice. Its delay has been explained by the Ministry as arising from the need to make it consistent with some special laws that are currently in place.

Regarding the legal framework for judicial reorganization, the Ministry of Justice has recently finalized two draft laws on the organization and functioning of the courts and on the amendment of law on the Supreme Council of Magistracy. The Ministry is now reviewing the draft law on the statute of judges and prosecutors, which was sent from the Supreme Council of Magistracy in August 2006.

The reinforcement of overall judicial powers and particularly those of the Supreme Council of Magistracy is critical if the judiciary's independence is to be adequately established. This supreme independency will help guarantee the separation of powers and eliminate the culture of interference in the judiciary by other branches of the state.

In particular, progress towards adoption of the anti-corruption law poses the most challenging questions. After the text was criticized in early 2006 as not yet compliant with international standards, further discussion and technical reviews have taken place. However, the draft has not yet been passed by the Council of Ministers. The Government linked this delay to the tardy adoption of the penal code, with which the anti-corruption draft law needs to be made compliant. Despite this argument, the delay has prompted a critical reaction from the donor community and civil society while the drafting process has already lasted for around a decade.

Table 10.1: Current Progress on the Eight Fundamental Legal Texts

| Legal Texts   | Status as of January 2007   | Deadline    |
|---|---|-------------|
| Penal Code  | MOJ, with the assistance of French cooperation, is completing the draft.  | End of 2006 |
| Civil Code  | The draft was sent to NA on 12 January 2007.  | End of 2006 |
| Penal Procedures Code   | The draft is being reviewed by the legislative commission of NA and waiting for the next session of the Assembly in March 2007.           | End of 2006 |
| Civil Procedures Code   | The code was promulgated on 6 July 2006.  | End of 2006 |
| Law on the Organization and Functioning of the Courts               | The draft is finalized by MOJ. MOC is drafting a separate law to establish the Commercial Court.  | End of 2006 |
| Law on the amendment of the Organization and Functioning of the SCM | The draft is finalized by the MOJ.  | End of 2006 |
| Law on the Statute of<br>Judges and Prosecutors                     | The draft is being reviewed by the Minister of Justice.  MOJ has received the draft from Supreme Council of Magistracy on 28 August 2006. | End of 2006 |
| Law on Anti-Corruption  | The adoption of this law is pending the adoption of the Penal Code by NA.   | End of 2006 |

Source: TWG on Legal and Judicial Reform.

Though not directly regulating economic or business activities, all of these laws are quite critical for the overall socio-economic development of the country. They will help build a sense of security among businessmen and investors through improved law enforcement institutions and anti-corruption bodies. Furthermore, the four principal codes will provide a general legal basis for commercial dispute resolution, where there are loopholes in the applicable commercial laws or regulations.

In the absence of these laws being adopted, the provision of incentives to encourage the enforcement of existing laws and regulations would be beneficial.

Firm action is necessary, in recognition of the fact that corruption and interference in the judiciary by other branches of state power are perceived by most Cambodians as the most serious obstacles preventing the fair and equitable enforcement of the law, and the even-handed dispensation of justice.

More attention should be paid to reorganizing the current reform process, by focusing especially on removing existing technical weaknesses, if avoiding the contentious topic of political will. It would be a good idea if the legal units of government institutions were staffed with young Cambodian legal professionals, and provided with appropriate foreign technical assistance, in order to sustainably transfer a degree of authentic legal knowledge and know-how to the Cambodian staff. The reform agenda should also be scheduled in a more realistic way, based on actual technical capacity and the scope of the work underway.

Sufficient and appropriate legal instruments together with an independent law enforcement body will provide Cambodians with the genuine, equitable legal system that they deserve. The new level of confidence in state governance among citizens and investors this could inspire, would bring innumerable social and economic benefits.

# Chapter 11

# Land and Natural Resource Management Reform

Since the majority of the rural poor rely heavily on land and natural resources, ensuring that these are distributed in an equitable and sustainable manner is essential for poverty reduction. That being the case, the result of land and natural resource management reform could strongly influence the Government's efforts to meet the Cambodia Millennium Development Goals (CMDG). So far much progress has been made. However, there are still many challenges ahead.

#### 11.1. Land Reform

The state of current land distribution is moving in an unhealthy direction both in terms of equity and efficiency. Concerning equity, Cambodia is moving further and further from equitable land distribution, with the number of landless people estimated to be an alarming 20 percent, yet some rich people are holding thousands of hectares. With regard to efficiency, opportunities have been missed, because of land speculation and inactive economic concession land.

This leads to rising conflict and increasing landlessness, ensuring that land reform remains the hottest issue within the development agenda. To alleviate these problems certain measures have been taken by the Government, including the cancellation of inactive economic land concessions, the enforcement of unused land taxes, and the implementation of social land concessions.

Information on the topic of economic land concessions has been made available to the public through the MAFF website<sup>20</sup>, and a technical secretariat was established by Decision No. 27 dated June 30, 2006. However, the information which has been disclosed fails to provide updates on the progress of each concession, such as actual planted areas, on an annual basis, which makes the monitoring and evaluation of each concession an impossible task.

Inactive concessions continue to be cancelled. Up to March 2007, 30 out of 96 companies have seen their concession contracts cancelled, affecting, in total 265,230 hectares<sup>21</sup>. Two of these 30 concession contracts, covering 44,200 hectares, have been cancelled during the last six months. However, according to an IMF report in July 2006, many companies still

<sup>&</sup>lt;sup>20</sup> www.maff.gov.kh/elc/

<sup>&</sup>lt;sup>21</sup> www.maff.gov.kh/elc/

retain concessions which remain idle: only 7 percent of economic land concessions is being planted <sup>22</sup>. New concessions continue to be made without proper public consultation with territorial authorities and local residents, as specified in the Sub-decree on Economic Land Concessions. As a result, conflicts arise among the local community and concessionaires<sup>23</sup>.

Concerning unused land taxes, sub-committees to valuate unused land have been formed and a decision on the valuation of land prices<sup>24</sup> was issued in December 2005. However, land prices tend to be valued much lower than the estimated market value, resulting in the undervaluation of their tax value. For example, land in central Phnom Penh was valued at around 150,000 Riel (\$36) per square meter compared to the US\$300 to US\$400 estimated by real estate companies. In addition, the implementation of unused land tax is very poor due to a lack of land titles and information on land ownership.

There are plans to settle 500 eligible households on social land concessions with livelihood support, in order to improve the standard of living of the rural poor. At least 10,000 hectares of suitable land have been confirmed as available for this use. However, progress has been slow, with the pilot plan moving sluggishly.

Concerning land titling, much was achieved during the second semester of 2006, following the slow progress which had been observed during the first semester. In the whole of 2006, 280,207 titles were issued through systematic land titling and 11,754 titles were issued through sporadic land titling<sup>25</sup>. As of December 2006, the total number of titles issued was 1,140,098, of which 564,000 were issued through systematic land titling and 576,098 were issued through sporadic land titling.

Regarding the issue of land grabbing, 191,090 hectares of forest land have been confiscated as a result of the implementation of the Government's Order of May 2006 on the Prevention of Deforestation for Land Ownership <sup>26</sup>. This indicates that the order has been enforced effectively. However, concerns have been raised about the way the order is implemented and its impact on small land holders.

<sup>&</sup>lt;sup>22</sup> IMF (2006), "Cambodia: 2006 Article IV Consultation --- Staff Report", International Monetary Fund, July 2006.

<sup>&</sup>lt;sup>23</sup> Cambodge Soir, September 25, 2006.

<sup>&</sup>lt;sup>24</sup> Decision No. 007 on the Valuation of the Tax Base Price of Unused Land, Land Appraisal and Valuation Committee.

<sup>&</sup>lt;sup>25</sup> MLMUPC (2006), "Progress Report of NSDP & Rectangular Strategic Implementation and the Next Action Plan, December 28, 2006", Ministry of Land Management , Urban Planning and Construction, Phnom Penh.

<sup>&</sup>lt;sup>26</sup> MAFF (2006), "Annual Report - 2006", Ministry of Agriculture Forestry and Fishery, Phnom Penh.

A Land Dispute Agency was established on February 26, 2006, with members from both the Government and the opposition party. According to ADHOC, a local human rights group, land conflicts between farmers and the authorities or companies were on the rise, totaling 450 in 2006 compared to 335 in 2005. These figures demonstrate that little has been achieved since the establishment of the Agency; however, its secretariat was only recently installed, on July 14, 2006, and the number of land disputes has decreased slightly since July 2006.

Overall, progress has been made in all areas of land reform. However, many daunting challenges remain. The implementation of unused land taxes and proper valuation of unused land are major priorities, along with the monitoring and evaluation of economic land concessions and further cancellation of inactive concessions. Proper public consultations must take place before new concessions are given, so as to prevent a rise in land conflicts.

More effort should be put into the social land concession program, since progress has been slow. The pace of land titling needs to be speeded up; otherwise the Government will not achieve its 2007 target of 1 million titles through systematic land titling.

# 11.2. Forestry Reform

Following a lost decade of failing commercial forest concessions, many positive efforts have been made to preserve as well as to enhance access of the rural poor to forestry resources. Many of the previously awarded concessions have been cancelled, leaving only 12 companies currently retaining forest concessions, compared to the peak period of 33 during 1994-1997. This leaves large areas of Production Forest within the Permanent Forest Reserve available for alternative management schemes such as Community Forestry<sup>27</sup>.

The development of community forestry has been among reform priorities and has seen stable progress. Recently, in May 2006, the National Community Forestry Programme Strategic Paper was issued, stipulating the Government's plan to offer formal recognition to the 274 existing Community Forestry sites which cover 218,657 hectares. The paper further intends to create an additional 200 to 400 formally recognized Community Forestry sites during the period of 2009-2013. Since this program was approved some action has been observed, including the development of a number of small project proposals, which are now waiting for funding.

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<sup>&</sup>lt;sup>27</sup> FA (2006), "National Community Forestry Programme Strategic Paper", Forestry Administration, Phnom Penh, May 2006.

Developments have also been seen in the enforcement of the Forestry Law, particularly regarding the fight to prevent forest land clearance and encroachment. A Prime Minister's Order on the Prevention of Deforestation was issued in May 2006 and has been implemented. As of January 2007, 207,960 hectares of forest land had been confiscated from offenders as a result of the implementation of the Order<sup>28</sup>.

Other areas of reform are also on the move. The process of forest demarcation is ongoing in 15 Forestry Administration cantonments. Concerning 2005-2006's forest cover assessment, the interpretation and classification of forest types has been completed and the independent data verification was initiated in December 2006.

However, some activities are behind schedule due to a shortage of funds and lack of inter-ministerial cooperation<sup>29</sup>. Forestry crime is still pervasive. According to MAFF, there were 711 suppressed forestry crimes in 2006, of which 431 have been sent to the courts. Many of the forest concessions still do not fully comply with the conditions of the Strategic Forest Management Plan (SFMP) and the Environment and Social Impact Assessment (ESIA), as required by the Forestry Administration.

## 11.3. Fishery Reform

Since the introduction of reform measures by the Government in October 2000, progress has been seen in the fishery sector. The transformation of fishing lots into community fishing is a positive step towards sustainability, equity and poverty reduction. It is also expected to be an effective tool in the fight against illegal fishing through the involvement of local communities. This transformation has seen 56.5 percent of fishing lot concession areas (538,522 hectares) reduced for the benefit of family fishing<sup>30</sup>.

The number of community fishing lots has increased steadily to 440 in 2005 and 509 in 2006. Presently, the Government is working to provide a legal basis for the development of community fishing. In June 2006, an implementing sub-decree was approved to make the Royal Decree of May 2005 on the Community Fisheries Establishment operational. This sub-decree is subject to further amendment to make it compliant with the new Fisheries Law of May 2006. Currently, the draft Prakas on Community

<sup>&</sup>lt;sup>28</sup> Progress Report of TWG on Forestry and Environment, Mar. 2006 – Jan. 2007.

<sup>&</sup>lt;sup>29</sup> Progress Report of TWG on Forestry and Environment, Mar. 2006 – Jan. 2007.

<sup>&</sup>lt;sup>30</sup> DoF (2006), "The Five Year Achievement Report of the Department of Fisheries (2001-2005)", Department of Fisheries and Japan International Cooperation Agency, Phnom Penh.

Fisheries Guidelines has been reviewed by MAFF, but its endorsement is pending the amendment of the previously mentioned sub-decree.

Improvement has also been made in other priority areas of the Fisheries Development Action Plan. Concerning conservation, many regulations have been drafted and conservation areas have been demarcated. Regarding marine conservation, a Ten-Year Action Plan for Coral Reefs and Sea-Grass has recently been adopted by MAFF. The Fishery Administration has prepared the maps for demarcating the boundaries of the flooded forest around Tonle Sap, including 15 communes in Kampong Chhnang province, 6 in Pursat and 3 in Kampong Thom.

Overall, there has been good progress in fishery reform especially regarding the development of a legal framework and establishment of community fishery lots. The adoption of the long awaited Fishery Law together with the transformation of the Department of Fisheries into the Fishery Administration would equip the Government with better tools for policy-making and administration as well as helping it to win the fight against illegal fishing. A dissemination workshop on Fishery Law was officially launched in October 2006 and a Prakas regulating the functioning of the Fishery Administration has been adopted by MAFF.

However, there are still constraints which need to be removed, such as funding shortages and limited human resource capacities. In addition, though steady progress on community fisheries has been seen in the field, much still needs to be done in order for fishing communities to become self-sustainable. Most remain extremely poorly organized, with 39 percent of them having no statute, 61 percent possessing no map, 72 percent having no action plan, and 81 percent being without a conservation area<sup>31</sup>. Furthermore, many fishing lots have yet to be demarcated, which serves to generate disputes.

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<sup>&</sup>lt;sup>31</sup> Progress Report of TWG on Fishery, Mar. 2006 – Jan. 2007.

# **Concluding Remarks**

Strong economic growth in Cambodia during recent years is no longer surprising news for either government officials or stakeholders. The focus is now on poverty reduction, which is playing a pivotal role in shaping the policy process for development. The simple reason for this is that there is no automatic mechanism to ensure simultaneous economic growth and poverty reduction.

Cambodia is expected to continue its strong economic growth in 2007. However, the growth continues to be mainly boosted by the fast-growing garment and tourism industries, and concentrated mainly in the capital Phnom Penh and its peripherals, and the tourist town, Siem Reap-Angkor. The rural-based and agricultural sectors are volatile and underdeveloped due to poor infrastructure.

The growth is unlikely to be concomitant with improvements in health, education and poverty reduction. Also, the prosperity created by growth has not been fairly distributed among the Cambodian people. This pattern of development has caused disparities between regions in terms of employment opportunities and income distributions. No significant change can be realized in the foreseeable future unless critical reforms gain new momentum.

The proliferation of land grabbing and land concentration continues to threaten the livelihood of the poor and the country's stability, as warned by the leader of Cambodia. Rationalization and viable land redistribution in the areas of land and natural resource management reform --with particular emphasis on the poor interests-- must be in place to cope efficiently with the population explosion.

Weakness of social justice has nurtured a widespread culture of impunity and corruption. The government must initiate policies to maximize social welfare by establishing itself as a truly benevolent state. Equitable and sustainable development can only be maintained by social justice, compassion and national pride. It can be started with adherence to professional ethics and high social morals.

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# KEY ECONOMIC INDICATORS

Table A1.1: Main Economic Indicators

|                                     | 1960  | 1990   | 2003  | 2004   | 2005   | 2006   | 2007   | 2008   |
|-------------------------------------|-------|--------|-------|--------|--------|--------|--------|--------|
| Nominal GDP (million US\$)          | 577   | 1,404  | 4,591 | 5,313  | 6,240  | 7,170  | 7,969  | 8,769  |
| Real GDP (% increase)               | 4.8%  | 4.5%   | 8.6%  | 10.0%  | 13.4%  | 10.4%  | 8.7%   | 7.6%   |
| GDP per Capita (US\$)               | 106   | 148    | 345   | 392    | 451    | 510    | 558    | 605    |
| GDP per Capita (% increase)         | -     | 7.1%   | 5.6%  | 13.8%  | 15.1%  | 13.1%  | 9.4%   | 8.3%   |
| Riel/Dollar Parity (year average)   | 35    | 537    | 3,975 | 4,016  | 4,092  | 4,116  | 4,100  | 4,100  |
| Inflation in Riel (year average)    | 4.0%  | 141.0% | 1.1%  | 3.9%   | 5.8%   | 4.7%   | 3.0%   | 3.0%   |
| Inflation in Dollar (year average)  | 4.0%  | 0.4%   | -0.3% | 2.9%   | 3.8%   | 4.1%   | 3.4%   | 3.0%   |
| Budget Revenue (% GDP)              | 19.7% | 3.1%   | 9.7%  | 10.0%  | 10.3%  | 9.9%   | 10.1%  | 10.2%  |
| Budget Expenditure (% GDP)          | 29.2% | 15.9%  | 15.1% | 13.9%  | 12.5%  | 13.9%  | 14.5%  | 14.6%  |
| Current Public Deficit (% GDP)      | -3.8% | -11.9% | 0.8%  | 1.6%   | 2.0%   | 1.0%   | 0.9%   | 1.0%   |
| Overall Public Deficit (% GDP)      | -9.5% | -12.8% | -5.4% | -3.9%  | -2.2%  | -4.0%  | -4.4%  | -4.4%  |
| Export of Goods (% GDP)             | 13.8% | 7.8%   | 45.0% | 44.5%  | 44.7%  | 45.9%  | 47.2%  | 48.2%  |
| Import of Goods (% GDP)             | 20.4% | 24.4%  | 53.1% | 56.1%  | 55.4%  | 58.6%  | 58.9%  | 58.3%  |
| Trade Balance (% GDP)               | -6.6% | -16.6% | -8.0% | -11.7% | -10.6% | -12.7% | -11.7% | -10.1% |
| Current Account Balance (% GDP)     | -7.9% | -16.8% | -5.9% | -9.2%  | -7.7%  | -9.5%  | -8.3%  | -6.7%  |
| Net Foreign Reserves (million US\$) | 57    | 0      | 634   | 710    | 834    | 1,019  | 1,173  | 1,342  |
| Money - M1 (% GDP)                  | 12.5% | 5.3%   | 5.0%  | 5.2%   | 5.0%   | 5.4%   | 5.8%   | 6.0%   |
| Money - M2 (% GDP)                  | 23.6% | 1.8%   | 13.2% | 15.0%  | 14.5%  | 18.1%  | 19.3%  | 20.2%  |
| Population (million)                | 5.5   | 9.5    | 13.3  | 13.5   | 13.8   | 14.1   | 14.3   | 14.5   |
| Labor Force (% Population)          | 43.9% | 41.7%  | 45.3% | 46.2%  | 46.9%  | 47.8%  | 48.7%  | 49.5%  |

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

Table A1.2: Budget Operations (Billion Riel)

|                         | 1960 | 1990 | 2003  | 2004  | 2005  | 2006  | 2007  | 2008  |
|-------------------------|------|------|-------|-------|-------|-------|-------|-------|
| Domestic Revenue        | 4    | 23   | 1,765 | 2,127 | 2,626 | 2,918 | 3,302 | 3,670 |
| Current Revenue         | 4    | 23   | 1,733 | 2,107 | 2,474 | 2,882 | 3,262 | 3,631 |
| Tax Revenue             | 3    | 13   | 1,220 | 1,577 | 1,911 | 2,271 | 2,621 | 2,931 |
| Direct Taxes            | 1    | 1    | 150   | 158   | 222   | 331   | 383   | 429   |
| Indirect Taxes          | 2    | 4    | 675   | 906   | 1,116 | 1,295 | 1,491 | 1,654 |
| VAT                     | 1    | 2    | 460   | 598   | 730   | 870   | 1,018 | 1,146 |
| Excise duties           | 0    | 0    | 198   | 304   | 380   | 418   | 466   | 500   |
| Others                  | 1    | 2    | 17    | 4     | 6     | 7     | 8     | 9     |
| Int'l Trade Taxes       | 1    | 9    | 395   | 513   | 573   | 645   | 746   | 848   |
| Imports                 | 1    | 9    | 375   | 491   | 551   | 617   | 718   | 816   |
| Exports                 | 0    | 0    | 18    | 19    | 19    | 24    | 24    | 24    |
| Others                  | 0    | 0    | 2     | 3     | 3     | 4     | 4     | 8     |
| Non tax revenue         | 1    | 10   | 513   | 530   | 563   | 611   | 642   | 700   |
| Fishery & Forestry      | 0    | 0    | 13    | 9     | 10    | 9     | 9     | 9     |
| Civil Aviation          | 0    | 0    | 22    | 27    | 30    | 30    | 36    | 42    |
| Royalties               | 0    | 0    | 5     | 8     | 2     | 2     | 2     | 2     |
| PTT                     | 0    | 0    | 120   | 94    | 123   | 83    | 93    | 104   |
| Other non tax revenue   | 1    | 10   | 354   | 392   | 398   | 487   | 502   | 543   |
| Capital Revenue         | 0    | 0    | 31    | 20    | 152   | 36    | 39    | 39    |
| Expenditures            | 6    | 120  | 2,757 | 2,962 | 3,182 | 4,112 | 4,725 | 5,265 |
| Capital Expenditures    | 1    | 7    | 1,171 | 1,193 | 1,215 | 1,520 | 1,769 | 1,994 |
| Through Nat'l Treasury  | 1    | 7    | 333   | 296   | 315   | 379   | 431   | 477   |
| Direct Foreign financed | 0    | 0    | 838   | 896   | 900   | 1,141 | 1,337 | 1,517 |
| Current Expenditures    | 5    | 113  | 1,586 | 1,769 | 1,967 | 2,592 | 2,956 | 3,272 |
| Defense and Security    | 2    | 89   | 411   | 423   | 451   | 520   | 588   | 683   |
| Salaries                | 1    | 9    | 287   | 296   | 306   | 327   | 354   | 411   |
| Other                   | 1    | 80   | 124   | 127   | 145   | 193   | 234   | 271   |
| Civil Administration    | 3    | 25   | 1,175 | 1,346 | 1,516 | 2,072 | 2,368 | 2,589 |
| Salaries                | 2    | 12   | 327   | 343   | 405   | 495   | 556   | 645   |
| Other                   | 1    | 13   | 848   | 1,003 | 1,111 | 1,577 | 1,812 | 1,943 |

Table A1.2: Budget Operations (Billion Riel) -continued

|                   | 1960 | 1990 | 2003 | 2004 | 2005 | 2006   | 2007   | 2008   |
|-------------------|------|------|------|------|------|--------|--------|--------|
| Current deficit   | -1   | -90  | 147  | 338  | 507  | 290    | 306    | 360    |
| Overall deficit   | -2   | -97  | -992 | -835 | -556 | -1,194 | -1,423 | -1,595 |
| Financing         | 2    | 97   | 992  | 835  | 556  | 1,194  | 1,423  | 1,595  |
| Foreign financing | 1    | 77   | 886  | 894  | 984  | 1,584  | 1,423  | 1,595  |
| Grants            | 1    | 70   | 382  | 372  | 538  | 790    | 461    | 477    |
| Loans (net)       | 0    | 7    | 504  | 522  | 446  | 794    | 962    | 1,118  |
| Domestic financed | 1    | 20   | 106  | -59  | -428 | -390   | 0      | 0      |
| Banks             | 0    | 20   | -3   | 25   | -199 | -333   | 0      | 0      |
| Others            | 0    | 0    | 109  | -84  | -229 | -57    | 0      | 0      |

**Source:** 1960-2006 MEF. 2007-2008 EIC projection.

Table A1.3: Balance of Payment (Million US\$)

|                              | 1960 | 1990 | 2003  | 2004  | 2005   | 2006   | 2007   | 2008   |
|------------------------------|------|------|-------|-------|--------|--------|--------|--------|
| Exports of Goods             | N/A  | N/A  | 2,087 | 2,589 | 2,910  | 3,696  | 4,077  | 4,577  |
| Imports of Goods             | N/A  | N/A  | 2,668 | 3,269 | 3,928  | 4,739  | 5,293  | 5,767  |
| Trade Balance                | N/A  | N/A  | -581  | -681  | -1,018 | -1,044 | -1,216 | -1,189 |
| Agriculture                  | N/A  | N/A  | 183   | 95    | 293    | 360    | 401    | 459    |
| Textiles & Garments          | N/A  | N/A  | 516   | 657   | 734    | 887    | 1,037  | 1,178  |
| Oil & Gas                    | N/A  | N/A  | -445  | -698  | -1,004 | -1,241 | -1,299 | -1,326 |
| Other Goods                  | N/A  | N/A  | -836  | -735  | -1,040 | -1,050 | -1,356 | -1,501 |
| Balance of Services          | N/A  | N/A  | 114   | 291   | 471    | 557    | 619    | 736    |
| Transportation               | N/A  | N/A  | -151  | -212  | -291   | -367   | -459   | -558   |
| Travel (Tourism)             | N/A  | N/A  | 353   | 505   | 699    | 871    | 1,077  | 1,291  |
| Others                       | N/A  | N/A  | -88   | -2    | 63     | 53     | 1      | 3      |
| Balance of Incomes           | N/A  | N/A  | -179  | -221  | -254   | -286   | -339   | -395   |
| Current Transfers (net)      | N/A  | N/A  | 413   | 428   | 440    | 500    | 513    | 526    |
| Private Transfers            | N/A  | N/A  | 197   | 219   | 229    | 259    | 264    | 269    |
| Government Transfers         | N/A  | N/A  | 217   | 209   | 211    | 241    | 249    | 257    |
| Current Accounts             | N/A  | N/A  | -233  | -183  | -360   | -273   | -423   | -323   |
| Capital & Financial Accounts | N/A  | N/A  | 317   | 287   | 464    | 400    | 571    | 602    |
| Official Loans               | N/A  | N/A  | 109   | 111   | 114    | 206    | 246    | 273    |
| Foreign Direct Investment    | N/A  | N/A  | 84    | 131   | 381    | 399    | 376    | 381    |
| Others (net)                 | N/A  | N/A  | 124   | 44    | -32    | -205   | -51    | -52    |
| Change in Foreign Reserves   | N/A  | N/A  | 83    | 104   | 103    | 127    | 147    | 279    |

Source: 2003-2006 EIC and NBC. 2007-2008 EIC projection.

Table A1.4: Monetary Survey (Billion Riel)

|                            | 1960 | 1990 | 2003   | 2004   | 2005   | 2006   | 2007   | 2008   |
|----------------------------|------|------|--------|--------|--------|--------|--------|--------|
| Net Foreign Assets         | 4    | 3    | 4,027  | 4,797  | 5,475  | 7,224  | 8,046  | 8,846  |
| Foreign Assets             | 4    | 18   | 4,741  | 5,482  | 6,142  | 7,650  | 8,513  | 9,354  |
| Foreign Liabilities        | 0    | -15  | -714   | -685   | -667   | -426   | -466   | -509   |
| Net Domestic Assets        | 3    | 58   | -698   | -467   | -450   | -282   | 150    | 579    |
| Domestic Credit            | 3    | 59   | 1,209  | 1,608  | 1,972  | 2,676  | 3,426  | 4,184  |
| Net Claims on Government   | 1    | 41   | -128   | -209   | -421   | -953   | -929   | -909   |
| Claims on Government       | 1    | 42   | 360    | 360    | 327    | 287    | 306    | 327    |
| Deposits of Government     | 0    | -1   | -488   | -569   | -748   | -1,240 | -1,235 | -1,235 |
| State Enterprises          | 0    | 13   | 0      | 0      | 0      | 2      | 2      | 2      |
| Private Sector             | 2    | 5    | 1,337  | 1,817  | 2,394  | 3,628  | 4,353  | 5,091  |
| Other Items (net)          | 0    | -1   | -1,907 | -2,075 | -2,423 | -2,959 | -3,276 | -3,605 |
| Total Liquidity            | 7    | 61   | 3,329  | 4,329  | 5,025  | 6,942  | 8,196  | 9,425  |
| Narrow Money               | 5    | 61   | 937    | 1,153  | 1,323  | 1,658  | 1,960  | 2,257  |
| Currency outside Banks     | 3    | 46   | 908    | 1,115  | 1,282  | 1,600  | 1,887  | 2,168  |
| Demand Deposits            | 3    | 15   | 29     | 38     | 41     | 58     | 73     | 89     |
| Quasi-Money                | 2    | 0    | 2,391  | 3,176  | 3,702  | 5,285  | 6,236  | 7,168  |
| Times and Savings Deposits | 2    | 0    | 82     | 97     | 113    | 89     | 106    | 124    |
| Foreign Currency Deposits  | 0    | 0    | 2,310  | 3,079  | 3,589  | 5,196  | 6,130  | 7,043  |

Table A1.5: Investment and Saving (Million US\$)

|                         | 1960 | 1990 | 2003 | 2004 | 2005  | 2006  | 2007  | 2008  |
|-------------------------|------|------|------|------|-------|-------|-------|-------|
| Total Investment        | 116  | 129  | 778  | 884  | 1,002 | 1,230 | 1,401 | 1,557 |
| Public investment       | 37   | 13   | 295  | 297  | 297   | 369   | 431   | 486   |
| Domestic financed       | 6    | 13   | 71   | 71   | 75    | 85    | 99    | 110   |
| Foreign financed        | 31   | 0    | 224  | 226  | 222   | 284   | 333   | 377   |
| Private investment      | 79   | 116  | 484  | 587  | 705   | 861   | 969   | 1,071 |
| Domestic financed       | 74   | 86   | 350  | 363  | 434   | 503   | 594   | 690   |
| Foreign financed        | 5    | 31   | 134  | 224  | 271   | 358   | 376   | 381   |
| Total Domestic financed | 80   | 99   | 421  | 433  | 509   | 588   | 692   | 799   |
| Total Foreign financed  | 36   | 31   | 357  | 450  | 493   | 642   | 709   | 758   |
| Agriculture Products    | 14   | 25   | 42   | 38   | 52    | 54    | 56    | 59    |
| Equipment               | 37   | 53   | 179  | 205  | 165   | 256   | 287   | 303   |
| Construction            | 65   | 51   | 557  | 641  | 784   | 920   | 1,058 | 1,196 |
| Total Saving            | 116  | 129  | 778  | 884  | 1,002 | 1,230 | 1,401 | 1,557 |
| National saving         | 71   | -106 | 507  | 396  | 523   | 552   | 736   | 967   |
| Government              | -22  | -167 | 37   | 84   | 124   | 70    | 75    | 88    |
| Non Government          | 93   | 61   | 469  | 312  | 399   | 481   | 661   | 879   |
| Foreign saving          | 45   | 236  | 272  | 488  | 479   | 679   | 665   | 591   |
| Grants                  | 42   | 6    | 243  | 237  | 255   | 295   | 305   | 315   |
| Non Grants              | 3    | 230  | 29   | 251  | 224   | 384   | 360   | 276   |

Table A1.6: GDP by Industry Origin at Current Prices (Million US\$)

|                           | 1960 | 1990  | 2003  | 2004  | 2005  | 2006  | 2007  | 2008  |
|---------------------------|------|-------|-------|-------|-------|-------|-------|-------|
| Agriculture               | 302  | 764   | 1,525 | 1,707 | 2,083 | 2,355 | 2,515 | 2,680 |
| Paddy                     | 126  | 163   | 349   | 346   | 517   | 550   | 567   | 599   |
| Other Crops               | 80   | 156   | 375   | 490   | 592   | 686   | 756   | 819   |
| Livestock                 | 26   | 102   | 221   | 234   | 291   | 333   | 366   | 402   |
| Fishery                   | 22   | 327   | 433   | 437   | 462   | 525   | 552   | 574   |
| Rubber & Forestry         | 47   | 17    | 146   | 200   | 221   | 261   | 274   | 285   |
| Industry                  | 89   | 170   | 1,146 | 1,347 | 1,534 | 1,796 | 2,051 | 2,301 |
| Garment                   | 16   | 18    | 577   | 709   | 772   | 926   | 1,071 | 1,206 |
| Food, Beverage & Tobacco  | 19   | 70    | 128   | 137   | 161   | 173   | 187   | 203   |
| Other Manufacturing       | 16   | 48    | 122   | 134   | 157   | 176   | 192   | 210   |
| Electricity, Gas & Water  | 5    | 6     | 26    | 30    | 31    | 34    | 37    | 42    |
| Construction & Mining     | 33   | 28    | 293   | 338   | 413   | 487   | 563   | 641   |
| Services                  | 186  | 470   | 1,921 | 2,259 | 2,624 | 3,019 | 3,404 | 3,788 |
| Transport & Communication | 15   | 64    | 288   | 340   | 413   | 486   | 547   | 613   |
| Trade                     | 485  | 584   | 650   | 764   | 881   | 983   | 1,093 | 1,197 |
| Hotel & Restaurants       | 16   | 3     | 181   | 224   | 264   | 330   | 394   | 459   |
| Other Private Services    | -408 | -212  | 700   | 827   | 952   | 1,094 | 1,237 | 1,376 |
| Public Administration     | 77   | 31    | 102   | 104   | 113   | 125   | 133   | 143   |
| Total GDP                 | 577  | 1,404 | 4,591 | 5,313 | 6,240 | 7,170 | 7,969 | 8,769 |

Table A1.7: GDP by Industry Origin at Constant 2000 Prices (Million US\$)

|                           | 1960  | 1990  | 2003  | 2004  | 2005  | 2006  | 2007  | 2008  |
|---------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| Agriculture               | 833   | 948   | 1,522 | 1,538 | 1,789 | 1,868 | 1,925 | 1,988 |
| Paddy                     | 179   | 197   | 372   | 327   | 469   | 474   | 473   | 485   |
| Other Crops               | 289   | 133   | 361   | 419   | 485   | 513   | 545   | 573   |
| Livestock                 | 64    | 206   | 233   | 243   | 257   | 279   | 295   | 313   |
| Fishery                   | 219   | 285   | 426   | 418   | 442   | 459   | 466   | 470   |
| Rubber & Forestry         | 82    | 127   | 130   | 131   | 136   | 144   | 146   | 147   |
| Industry                  | 549   | 221   | 1,153 | 1,347 | 1,513 | 1,772 | 2,021 | 2,251 |
| Garment                   | 104   | 5     | 612   | 764   | 842   | 1,027 | 1,208 | 1,368 |
| Food, Beverage & Tobacco  | 121   | 87    | 127   | 125   | 135   | 139   | 146   | 153   |
| Other Manufacturing       | 100   | 55    | 116   | 120   | 132   | 144   | 152   | 160   |
| Electricity, Gas & Water  | 39    | 5     | 21    | 22    | 23    | 25    | 26    | 28    |
| Construction & Mining     | 186   | 69    | 277   | 315   | 380   | 438   | 490   | 542   |
| Services                  | 1,529 | 712   | 1,858 | 2,100 | 2,350 | 2,601 | 2,837 | 3,057 |
| Transport & Communication | 125   | 100   | 283   | 304   | 344   | 375   | 407   | 443   |
| Trade                     | 480   | 561   | 637   | 709   | 775   | 824   | 886   | 937   |
| Hotel & Restaurants       | 187   | 37    | 164   | 202   | 237   | 292   | 337   | 381   |
| Other Private Services    | 142   | -25   | 686   | 801   | 906   | 1,023 | 1,118 | 1,204 |
| Public Administration     | 596   | 40    | 89    | 83    | 88    | 86    | 89    | 91    |
| Total GDP                 | 2,910 | 1,881 | 4,533 | 4,984 | 5,653 | 6,240 | 6,783 | 7,295 |

Table A1.8: GDP by Expenditure Categories at Current Price (Million US\$)

|                               | 1960 | 1990  | 2003          | 2004  | 2005  | 2006  | 2007  | 2008  |
|-------------------------------|------|-------|---------------|-------|-------|-------|-------|-------|
| Private Consumption           | 423  | 1,490 | 3,852         | 4,545 | 5,305 | 6,071 | 6,586 | 7,067 |
| Government Expenditure        | 108  | 173   | 245           | 239   | 256   | 336   | 384   | 425   |
| Gross Domestic Formation      | 86   | 96    | 986           | 922   | 1,216 | 1,494 | 1,701 | 1,891 |
| Gross Fixed Capital Formation | 84   | 93    | 839           | 929   | 1,086 | 1,333 | 1,518 | 1,688 |
| Changes in Stock              | 2    | 3     | 147           | -6    | 131   | 161   | 183   | 203   |
| Exports of Goods & Services   | 60   | 85    | 2,637         | 3,396 | 4,033 | 4,794 | 5,567 | 6,335 |
| Goods FOB                     | 58   | 79    | 2,088         | 2,591 | 2,914 | 3,438 | 3,930 | 4,413 |
| Service                       | 2    | 5     | 549           | 805   | 1,119 | 1,356 | 1,637 | 1,923 |
| Imports of Goods & Services   | 120  | 353   | 3,104         | 3,786 | 4,578 | 5,556 | 6,265 | 6,897 |
| Goods FOB                     | 106  | 307   | <b>2,</b> 670 | 3,271 | 3,931 | 4,782 | 5,340 | 5,818 |
| Service                       | 14   | 46    | 434           | 515   | 648   | 774   | 924   | 1,079 |
| Statistical Discrepancy       | 22   | -86   | -25           | -4    | 8     | 30    | -4    | -53   |
| GDP                           | 577  | 1,404 | 4,591         | 5,313 | 6,240 | 7,170 | 7,969 | 8,769 |

Table A1.9: GDP by Expenditure Categories at Constant 2000 Prices (Million US\$)

|                               | 1960  | 1990  | 2003  | 2004  | 2005  | 2006          | 2007  | 2008  |
|-------------------------------|-------|-------|-------|-------|-------|---------------|-------|-------|
| <b>Private Consumption</b>    | 1,560 | 1,898 | 3,796 | 4,271 | 4,794 | 5,326         | 5,663 | 5,947 |
| Government Expenditure        | 832   | 224   | 243   | 229   | 232   | 270           | 299   | 318   |
| Gross Domestic Formation      | 471   | 115   | 1,016 | 909   | 1,170 | 1,392         | 1,532 | 1,653 |
| Gross Fixed Capital Formation | 452   | 110   | 840   | 916   | 1,055 | 1,255         | 1,382 | 1,490 |
| Changes in Stock              | 19    | 5     | 176   | -7    | 115   | 137           | 151   | 162   |
| Exports of Goods & Services   | 246   | 71    | 2,676 | 3,436 | 4,003 | 4,580         | 5,133 | 5,652 |
| Goods FOB                     | 238   | 65    | 2,135 | 2,676 | 3,001 | 3,409         | 3,768 | 4,099 |
| Service                       | 8     | 6     | 541   | 760   | 1,002 | 1,171         | 1,366 | 1,553 |
| Imports of Goods & Services   | 498   | 307   | 3,216 | 3,853 | 4,547 | 5,323         | 5,793 | 6,163 |
| Goods FOB                     | 441   | 268   | 2,788 | 3,386 | 3,997 | <b>4,</b> 690 | 5,062 | 5,337 |
| Service                       | 57    | 39    | 428   | 468   | 550   | 633           | 731   | 826   |
| Statistical Discrepancy       | 300   | -120  | 18    | -7    | 0     | -5            | -52   | -111  |
| GDP                           | 2,910 | 1,881 | 4,533 | 4,984 | 5,653 | 6,240         | 6,783 | 7,295 |

Table A1.10: Employment by Sector (000's)

|                           | 1960  | 1990  | 2003  | 2004  | 2005  | 2006  | 2007  | 2008  |
|---------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| Agriculture               | 1,922 | 2,962 | 3,935 | 4,040 | 4,149 | 4,257 | 4,361 | 4,462 |
| Paddy                     | 1,522 | 1,997 | 2,785 | 2,862 | 2,941 | 3,018 | 3,094 | 3,167 |
| Other Crops               | 234   | 401   | 483   | 498   | 513   | 528   | 542   | 557   |
| Livestock                 | 65    | 327   | 378   | 389   | 400   | 410   | 421   | 431   |
| Fishery                   | 74    | 193   | 251   | 254   | 256   | 259   | 261   | 262   |
| Rubber & Forestry         | 26    | 44    | 37    | 38    | 40    | 41    | 43    | 44    |
| Industry                  | 99    | 218   | 578   | 629   | 689   | 758   | 818   | 873   |
| Garment                   | 14    | 37    | 257   | 294   | 323   | 368   | 407   | 442   |
| Food, Beverage & Tobacco  | 24    | 72    | 84    | 83    | 87    | 88    | 91    | 94    |
| Other Manufacturing       | 28    | 50    | 60    | 62    | 65    | 69    | 71    | 73    |
| Electricity, Gas & Water  | 2     | 3     | 7     | 8     | 8     | 8     | 8     | 9     |
| Construction & Mining     | 30    | 57    | 170   | 183   | 206   | 225   | 241   | 256   |
| Services                  | 299   | 752   | 1,031 | 1,065 | 1,119 | 1,175 | 1,208 | 1,236 |
| Transport & Communication | 28    | 38    | 64    | 67    | 73    | 77    | 81    | 85    |
| Trade                     | 138   | 270   | 354   | 353   | 375   | 396   | 402   | 405   |
| Hotel & Restaurants       | 21    | 5     | 68    | 78    | 86    | 98    | 107   | 115   |
| Other Private Services    | 54    | 133   | 209   | 231   | 252   | 270   | 284   | 296   |
| Public Administration     | 58    | 306   | 335   | 335   | 335   | 335   | 335   | 335   |
| Total                     | 2,320 | 3,932 | 5,544 | 5,734 | 5,958 | 6,190 | 6,387 | 6,570 |

 $\textbf{Source:} \ EIC, \textit{Compiled from government and international organizations primary data}.$ 



# KEY STRUCTURAL REFORMS

#### Box A2.1: Cambodia Key Reforms in Trade Openness Policy and Investment (2001-2007)

#### 2001:

- Since early 2001 Cambodia benefited from the EU's Everything But Arms (EBA) initiative, which grants duty-free and quota-free access for all exports (except arms) originating from Cambodia. With Cambodia's entry into the Association of Southeast Asian Nations (ASEAN), the European Union (EU) granted Cambodia the Regional Cumulation and Derogation Benefit Status, offered under the EU Preferential Rules of Origin. The derogation was prolonged until the end of 2006. The EU is ranked as Cambodia's second most important destination for exports, after the United States (US) and Cambodia's third most important trade partner, after the US and Thailand. Since Cambodia does not have a well-developed textile sector, it has not always met the standard of the Rules of Origin (ROOS) requirements and this has made some of its garment exports to EU markets subject to 12 % average rate of duty.
- The Royal Government of Cambodia (RGC) reduced maximum tariff rates from 120 percent to 35 percent and reduced the number of tariff bands from 12 to four. Structure of the four tariff bands are 0%, 7%, 15% and 35%, of which about 95% of the tariff lines are under three bands: 7%, 15% and 35%.
- Average un-weighted tariff rates lowered to 16.5% from 17.3% in 2000 and 18.4% in 1997. The rate had been lowered to 14.7% by 2005.
- The RGC imposed an absolute ban on exports of logs and an export quota on rice. Five items are subject to export licensing requirement: (i) processed wood products, (ii) garments, (iii) weapons, (iv) all vehicles and machinery for military purposes and, (v) pharmaceuticals and medical materials. Most non-trade barriers were eliminated in 2001.

#### 2002:

• Following the presentation of its Pro-poor Trade Strategy at the July 2001 third Consultative Group (CG) meeting in Tokyo, the RGC and donors agreed to prepare the Diagnostic Trade Integration Study (DTIS-IF). It was released in January, and was led by the World Bank (WB) and a team of national and international consultants. Most non-trade barriers were eliminated. Cambodia, one of the first three pilot countries under the revamped Integrated Framework for Trade-related Technical Assistance, was considered very successful and the concept has now been replicated in 20 other Least Developed Countries (LDCs).

#### 2003:

- Cambodia was approved to become 147th World Trade Organization (WTO) member at Cancun 5<sup>Th</sup> WTO
  Ministerial Conference (September 10-14, 2003) following a successful five rounds of working party
  negotiations with its multilateral and bilateral market partners. Cambodia achieved full membership of the
  WTO on October 13, 2004.
- Cambodia became a signatory of the ASEAN-China Free Trade Area's Early Harvest scheme, in July.
  Under the scheme Cambodia received a Special Preferential Tariff (SPT) treatment for 297 products at
  0% tariff rates for Chinese markets, effective from January 1, 2004. Under ASEAN and LDC status,
  Cambodia also received SPT treatment from a number of other countries including the EU member
  states, Japan, Korea, Canada, Thailand, etc.

# 2005:

- On January 1, the Bilateral Textiles Agreement with the US government, signed in 1999, expired. On May 27, the US Department of Commerce introduced a safeguard to limit the increase of its Chinese textile imports to 7.5% a year. The move was followed on June 10, by the signing of a European Union Memorandum of Understanding with China to limit Chinese textile imports to between eight and 12.5%. This safeguard will expire by the end of 2008.
- The Tariff Relief Assistance for a Development Economy (TRADE) bill was introduced in both the US
  Senate and the House of Representatives. The bill would grant Cambodia, and 14 other developing
  countries, duty-free access to the US markets. Modeled on the Africa Growth and Opportunity Act
  (AGOA), it provides special access of textile and clothing exports from lesser-developed countries in

Sub-Saharan Africa to the US markets.

- During July, representatives of the RGC and Garment Manufacturer Association (GMAC) lobbied the US
  government to pass the TRADE bill that had already been introduced in both the US Senate and the
  House of Representatives. If the TRADE bill were passed, it would obviously help the Cambodian
  garment industry achieve a more sustainable future.
- China granted Cambodia an additional 83 products duty-free access to its markets. In total, Cambodia has received SPT treatment for 380 products at 0% tariff rate for Chinese markets.

#### 2006:

- In July, the Commerce Minister went to the US to call for duty-free access to US markets for 15 LDCs in Asia. It is seen as crucial for the health of Cambodia's garment industry, to enable it to compete with other exporters such as China and Vietnam. Since 2005, a bill entitled the TRADE Act 2005 has been before the US Congress to extend duty-free access to the 15 LDCs. It would eliminate 17-to-20-percent of tariffs currently imposed on Cambodian garment exports to the US. The US has already approved this policy for Africa.
- On July 14, 2006, Cambodia reached an agreement and signed a Trade and Investment Framework Agreement (TIFA) with the US.
- On August 2, Vietnam offered SPT treatment to 40 Cambodian agricultural products, giving them duty-free access to its markets. Tobacco and rice were excluded from the list and are subject to quota restrictions. Vietnam and Cambodia plan to establish seven Special Economic Zones (SEZs) along their border and open eight more international border checkpoints and nine national border checkpoints in order to expand trade.
- On December 5-7, the Prime Ministers of Cambodia, Vietnam and Laos met in Dalat to discuss the
  development of an economic triangular area incorporating the three countries' mutual border provinces.
  The Prime Minister of Cambodia indicated during the meeting that the plan will include the Cambodian
  provinces of Ratanakkiri, Mondolkiri and Stung Treng and these provinces will become a major economic
  engine by 2015, focusing on mining, agro-industry and ecotourism.

### 2007

- Since January, work has been continuing on the bilateral Cambodian-Japanese Investment Protection
  Agreement. Under the deal, which is expected to be signed by mid-2007, Cambodia guarantees a free
  market, privatization and facilitation of procedural work for prospective Japanese investors. This is in
  addition to what is stipulated in the investment law, which ensures no discrimination, nationalization or
  price intervention from the government, but requires domestic shares in foreign-owned companies.
- On January 16, the Office of the Council of Ministers (OCM) submitted the second protocol of the Greater Mekong Sub-region (GMS) on Facilitation of Cross Border Transport of Goods and People to the National Assembly for approval.
- On February 12, first Joint-Council meeting held between US trade representatives and RGC officials, led by the Commerce Minister, in Siem Reap. This meeting was the follow-up of TIFA which was signed in July 2006. The meeting aimed to strengthen relationships and give participants a deeper understanding of Cambodia's economic and political structures, as well as the challenges faced by its trade sector. During the meeting, there were exchanges of views on the legal framework, standard and capacity building, intellectual property, Sanitary and Phytosanitary (SPS), Generalized System of Preference (GSP), etc.
- Preparation of the Updated Diagnostic Trade Integration Study (Updated DTIS) or Enhanced Integrated
  Framework (IF) has been underway, lead by the Ministry of Commerce (MoC) and United Nations
  Development Programs (UNDP). The report is expected to be released by mid-2007.

Sources: Various Government Reports, IF Report.

## Box A2.2: Cambodia Key Policy Reforms in Private Sector Development (2001-2007)

#### 2002:

- The MoC set its mission statement as "The Year of Decentralization and Deregulation", aiming to reduce paperwork procedures in dealing with export activities. It introduced a computerized system, in coordination with the US Customs Department, for monitoring garment exports.
- Law on Marks, Trade Names and Acts of Unfair Competition passed by the National Assembly.

#### 2003:

- In January, the Law on Copy Rights and Related Rights passed by the National Assembly.
- In February, the Amended Law on Investment passed by the National Assembly to make investment climate more conducive to growth.
- Law on the Amendment of the Law on Taxation passed by the National Assembly.
- Law on Patents, Utilities Model, Certificates and Industrial Design passed by the National Assembly.

#### 2004:

- The government and donors, led by the World Bank, identified a 12-point action plan to tackle impediments in the private sector. These were mapped out in the World Bank Investment Climate Assessment Report released in August. The 12-point implementation plan is to improve competitiveness of Cambodian investment climate and trade facilitation.
- The government established a Steering Committee of Private Sector Development, consisting of eight ministries/agencies, to lead and oversee the change process in private sector development reform.
- Another three Sub-steering Committees of Private Sector Development also established by the government: (i) Sub-steering Committee on Investment Climate and Private Participation in Infrastructure (PPI) led by Sr. Minister of Economy and Finance, (ii) Sub-steering Committee on Trade Facilitation led by Sr. Minister of Commerce, and (iii) Sub-steering Committee on SME led by Minister of Industry, Mines and Energy. Each sub-committee is in charge of its relevant reform agenda.
- A Trade Facilitation Reform Team established to work under the guidance and leadership of the Sub-steering Committee of Trade Facilitation, chaired by Sr. Minister of Commerce.
- MoC reduced the Commercial Registration fees from US\$630 to US\$177 (Prakas #162 MoC/ M 2004, effective from September 01). It also reduced the time for the Commercial Registration to two and an half days (MoC's announcement letter #1971 MoC/ M 2004, effective from September 01) and the minimum capital requirement for enterprise establishment from CR 20 million (US\$5,000) to CR 4 million (US\$1,000).
- On May 12, the number of steps in the procedure and processing application for Certificate of Origin (C/O), Visa
  on Commercial Invoice and Export License at MoC reduced from 11 to eight. Processing time for issuance of
  application for C/O, Visa on Commercial Invoice, and Export License reduced from 16 business hours (March
  2002) to 12 business hours from May 12, 2004.

#### 2005:

- The Council for the Development of Cambodia (CDC) cancelled the "deposit requirement" to secure project
  implementation by investors, and foreign companies have been entitled to a 100% ownership of their businesses
  except the ownership of land.
- Investment Proposal Review Sub-committee established in provinces to allow approval of investment projects of
  less than US\$2 million. Committees comprise: i) Provincial Governor, Chairman of the Investment Subcommittee, ii) First Deputy Governor, Vice-Chairman, iii) Second Deputy Governor, Vice-Chairman, and 13 other
  members from different municipal departments.
- Costs and times reduced for Commercial Registration at the MoC. Also reduced times and procedures for application of C/O, Visa of Certified Invoice and Export Licenses. Certificate of Processing (C/P) no longer required by the Ministry of Industry, Mines and Energy (MIME).
- The requirement of C/O for pre-shipment is no longer necessary. C/O can be submitted post-shipment in order to speed up export of goods.

- Separate on-site inspections by Customs and CamControl changed to joint simultaneous on-site inspections from September 1, where only one joint inspection document is used.
- RGC offered to establish a permanent, joint Customs-CamControl Focal Point/Office in garment factories with over 2,000 employees, to facilitate and speed up the inspection and clearance process.
- Improvements led to a reduction of time spent on import transactions with all government agencies from 30 days in 2003 to 10.5 days in July 2005 and export transactions reduced from 20 days in 2003 to 6.6 days in July 2005. Average per transaction costs for processing exports meanwhile declined from US\$942 in 2003 to US\$612 in July 2005 and average import costs fell from US\$2,477 in 2003 to US\$673 in July 2005. Informal fees also declined from 5% per total consignment value in 2003 to 2% in July 2005 survey done by EMC in August 2005, commissioned by the WB-funded Trade Facilitation and Competitiveness Project (TFCP).
- On May 17, Law on Commercial Enterprise passed by the National Assembly.
- Law on Negotiable Instruments and Payment Transactions passed by the National Assembly.
- On July 15, Law on Concession passed by OCM and submitted to the National Assembly for approval.
- On September 27, the RGC issued Sub-decree #111 on implementation of amendment law of the Law on Investment of the Kingdom of Cambodia.
- Prime Minister signed Sub-decree on the Establishment and Management of SEZs. Promulgation of Sub-decree effective from 29 December 2005.
- 14 SEZs approved for 10 provinces and One-Stop-Service approach is employed in the zone.
- The RGC adopted the Small and Medium Enterprise (SME) Development Framework in 2005 as its strategy for SME development through to 2010

### 2006:

- The government adopted and issued Sub-decree #21, Risk Management Strategy, Guidelines for Implementation. The Prime Minister signed a single-package document containing Sub-decree on March 1, 2006.
- In March, Law of Commercial Arbitration passed by the National Assembly.
- Law on Management of Factories and Handicrafts passed by the National Assembly.
- Sub-decree on Risk Management approved by the Prime Minister.
- Civil Protection Code approved by the Government.
- The RGC issued Sub-decree #84 on Creation of Anti-Corruption Entity.
- Provincial Chamber of Commerce Offices opened in Phnom Penh, Battambang, Siem Reap, Sihanoukville, Kampong Cham, Kampot, Takeo, Kampong Speu, Posat, Banteay Meanchey and Kandal. No plan to open offices in all 24 provinces, as not enough trading/business activities.
- The RGC signed a ASYCUDA-World project document package with UNCTAD on April 18, 2006 to automate its Customs and Excise Department (CED). ASYCUDA (Automated SYstem for CUstom DAta) is the most upto-date version of the UNCTAD-designed Information Technology package for Customs automation and modernization. ASYCUDA is funded under the World Bank's Trade TFCP.

## 2007:

Export Management Fee reduced from 1% to 0.9% of total export value.

Source: Various Government Reports.

### Box A2.3: Cambodia Key Reforms in Public Financial Management and Revenue (2001-2007)

#### 2001

- Introduced visa sticker to avoid tax loss from visa revenues, stamp system on cigarettes, expanded VAT on real regime (self-assessment system) to additional 150 firms (following the 2000 expansion by 500 companies) and introduced a 10% excise tax on entertainment services.
- The minimum profit tax of 1% was eliminated on investment projects.

#### 2002

- Raised additional tax on petroleum products, two cents per litre for gasoline and four cents per litre for diesel, excise tax on beer from 10% to 20% and expanded real tax regime (real tax regime means taxation based on accounting statement) to cover additional five provinces (it was previously applied to five provinces only)<sup>1</sup>.
- In July, the Law on Corporate Accounting, Audit and the Accounting Profession was passed and promulgated.
- Applied a 15% withholding tax on interest earned by bank depositors.
- Introduced Medium Term Expenditure Framework 2003-2005.
- Streamlined the system for controlling refunds and developed risk management techniques for the verification and approval of VAT refund claims.
- Established a single operational structure for government bank accounts in the National Bank of Cambodia under government control.
- Established a structure for a Chart of Accounts (COAs) at the national treasury.
- Introduced direct payment to the National Bank of Cambodia (NBC) for large taxpayers.

- Issued Treasury Bill for CR 50 billion.
- Law on the Amendment of the Law on Taxation was adopted by the National Assembly on March 3. The main points of these amendments are as follows:
- Changed exemption period
- Introduced 40% special depreciation for the Qualify Investment Project (QIP), for investors not electing to use exemption period
- Introduced new depreciation schedules (declining balance method)
- Introduced additional profit tax on dividend distribution
- Reduced withholding tax on payment to non-residents from 15% to 14%
- Reduced withholding tax on interest payment from bank to resident taxpayers from 15% to 6% and from 5% to 4%.
- Increased rate of salary tax for non-resident taxpayers from 15% to 20%
- Eliminated 1% of turnover of minimum tax and pre-payment of profit tax on QIP
- Strengthened collection enforcement
- Expanded the coverage of Medium Term Expenditure Framework (MTEF) to: i) Ministry of Agriculture, Forestry and Fisheries (MAFF), ii) Ministry of Rural Development (MRD), iii) Ministry of Public Works and Transport (MPWT). MTEF possibly to be expanded to Ministry of Justice and Ministry of Women's and Veterans' Affairs.
- The Prime Minister's circular, ordered the Ministry of Economy and Finance (MEF) not to sign new

<sup>&</sup>lt;sup>1</sup> The real regime tax system was expanded in 2000 to five provinces: Sihanoukville, Koh Kong, Siem Reap, Kompong Cham and Battambang. In 2002, the real regime system was expanded to another five provinces: Kandal, Svay Rieng, Kampot, Kompong Speu and Kompong Chhnang.

payment orders without sufficient cash in the national treasury.

- Established Kampuchea Institute of Certified Public Accountants and Auditors (KICPAA) to ensure promotion of the accountancy and auditing professions.
- Increased excise tax rate on beer from 20% to 30%. Increased excise tax on air transportation and telecommunications from 2% to 10% and broadened both domestic and international tax base, effective from 1 January.

#### 2004

- The MEF put stiffer pressure on Government's private debtors and set January 31 as the deadline to all vehicle owners to pay tax or have vehicles confiscated.
- The Government reduced import tax on luxury vehicles from 230% to 50% beginning January 1, with the expectation that reduction in tax would prompt and encourage people to pay it.
- Established a Budget Monitoring and Cash Management Commission (BMC) to: i) prepare and monitor budget performance and its policies, ii) provide assistance and recommendation to budget law preparation, iii) set up reviews on a six-month basis of budget execution, iv) manage expenditure reflecting the National Treasury's capacity, and v) improve and monitor priority expenditure such as Priority Action Programme (PAP).
- In September, reform of Public Financial Management (PFM) launched by an 11-donor team, in which the WB is playing a crucial role. This sector-wide approach PFM reform is a multi-year agenda, focusing on reducing fiducial risks of public expenditure and financial management, and improving fiducial accountability. The reform, which is key to reducing corruption, involves computerization of a number of key revenue departments, keeping track on revenue collections and expenditures, and timely reporting of transactions to the National Treasury. Also some 200 individual actions to be undertaken at departmental level over a period of fifteen months.
- MEF issued a Prakas letter to all large and medium tax payers to pay their taxes through the bank account
  of the NBC.

- Department of Non-Tax Revenue established, with duties to develop policy and strategy to: i) manage non-tax revenue, ii) prepare standard letters on management of non-tax revenue, iii) sum-up non-tax revenues and debts on monthly basis, iv) collect information on non-tax revenues, v) manage revenue collection from post and telecommunications, vi) manage tax on embassies, vii) passports viii) garment licences, xi) tourism, x) civil aviation. It also has duties to manage other non-tax revenues other than State property and financial industries. It is bound to effectively implement measures for getting non-tax revenues under its competence, research sources of other non-tax revenue and participate in preparing annual budget plan.
- April 1, Prakas issued on Determination of Solvency of Insurance Companies. Insurance license to be valid for a period of five years and companies to have adequate funds for solvency a minimum of a US\$1.5 million. This amount includes a deposit of US\$700,000 at the NBC which may be cash or check with permission from MEF or 30% of next premium revenue in the financial statement for the last year. Profits of insurance companies not allowed to be distributed as dividends to their stakeholders unless it is agreed in writing that the companies have met or may continue to meet solvency obligations in the near future.
- On April 22, instructional circular on VAT Refund Mechanism issued. It states that VAT taxpayers meet the following conditions to request a VAT refund: (i) have monthly excess VAT input tax credits (for companies having exports as their main business and investment companies), or have excess VAT input tax credits for three consecutive months or more (for other taxpayers), (ii) have proof of input tax payment, (iii) have proof of exports subject to 0% rate, and (iv) have reliable accounting records.
- On June 1, introduction of income tax for garment workers. Workers with over US\$125 monthly income will be subject to 5% income tax, over US\$250 be subject to 10% tax, over US\$2,125 be subject to 15% tax and over US\$3,125 be subject to 20% income tax.
- Effective from June 1, Prakas issued to all taxpayers to make payments through NBC. Payments of more

- than CR 4 million to be paid by cheque; payments of less than CR 4 million to be paid either by cheque or in cash at NBC.
- On June 3, creation of Unused Land Appraisal and Valuation Sub-commission. The duties of the Sub-commission are to publicize law on tax collection for unused land, identify unused land and estimate taxes to be paid to the government.
- On July 14, Prakas issued to introduce Accommodation Tax. Due to complaints from the Tourism Association of Cambodia, this accommodation tax may not be applied until January 2007.
- On September 19, MEF issued Prakas #578, Using the Joint Financial Management Procedures. This is for projects sponsored by the WB and ADB and the procedure will also be implemented for financing projects from other donors if agreed.

- On February 3, Governance Action Plan II (2005-2008) approved by OCM.
- On March 13, MEF Notice #007 introduced the implementation of special tax on telephone services. All
  telephone companies in Cambodia operating services inside and outside the country to pay specific 3%
  tax, commencing April 1.
- National Assembly approved the National Strategy Development Plan (NSDP) 2006-2010, in which the main objectives are to reduce the poverty rate to 25% and to lower the unemployment rate to less than 4%.
- Establishment of internal audit departments along the government line ministries.
- On April 26, OCM Prakas #665 issued to all ministries/institutions specifying that selection of civil servants must be done through a competitive examination.
- On June 9, MEF Prakas issued for promulgating the document Code of Ethics for Internal Auditors and Internal Auditing Professional Standards.
- On June 16, MEF circulated Prakas relating to the extension of tax exemption on profits, for two more years, for investment enterprises of export-oriented garment, textile and shoe manufacturing sectors. This only applies to investment enterprises which received CDC approval for investment in Cambodia before March 14, 2005. On June 27, The World Bank Board of Executive Directors approved the Public Financial Management and Accountability Project. The project will support the Government's Public Financial Management Reform Program (PFMRP) in six specific areas: i) revenue management; ii) budget formulation; iii) budget execution; iv) capacity development; v) a Merit Based Pay Initiative (MBPI) which will help reform the civil service; and vi) building the oversight capacity of Cambodia's National Audit Authority. The Government-led Public Financial Management Reform program has been underway since 2004 and has already achieved results. Revenues have increased by 20% from 2004 to 2005; the amount of customs revenue collected through the banking system has increased from 0% in 2004 to 36% in 2005, and 86% of all Tax Department revenue is now collected through the banking system; the stock of old expenditure arrears has been reduced by over 40%; the procurement process has been streamlined and tightened; five line ministries have established internal audit departments; and, for the first time in Cambodia, a pilot program has been launched to pay civil servants through commercial banks instead of by cash. The reform program is supported by 11 donors — ADB, IMF, the WB, UNDP, Australia, European Commission, France, Germany, Japan, Sweden and United Kingdom - four of whom are contributing about US\$17 million to the WB-managed multi-donor trust fund, set up to co-finance the implementation of this program.
- On March 3, Law on the Audit of the Kingdom of Cambodia, promulgated. Requires respective ministries/institutions and public enterprises to create and strengthen Internal Management System and Internal Audit.
- On November 27, Sub-decree #129 on Rules and Procedures of Reclassification of Public Property of the State and State-owned Institutions – indicated that the leases on state properties should not be allowed to exceed 15 years.
- Sub-decree requiring an establishment of internal audit department at all line ministries issued. Five line ministries have established internal audit departments and two of them are operational.

- By end of 2006, 40 % of revenue collected through banking system. Strategy developed for gradually increasing revenue collected through the banking system based on geographical roll-out of requirement.
- A booklet format of Macro-Fiscal data is being developed.
- Prakas on fees on construction services implemented.
- PAP to be replaced by program budgeting PB in 2007. The new initiative to be piloted in seven ministries, including the four PAP ministries.
- Good progress made in strengthening debt management. An assessment of the institutional aspects of
  debt management is completed and progress made with selection of a new software package for debt
  management and with staff capacity building. Documents on Standard Operating Procedures,
  Procurement, and Financial Management produced, and staff training conducted. A draft Debt
  Management Manual for Department of International Cooperation for staff is completed.
- A pilot for direct payment of senior officers' salaries into bank accounts is trialled in MEF and MoH and will be extended to other ministries and two provinces.
- Government agreed to contribute to MBPI and incorporate it in the annual budget of MEF. MBPI for
  government staff involved in the PFMRP introduced. Regular payments for the agreed 263 participants
  commenced in November 2005 (backdated to July 2005). MBPI was funded from the Multi Donor Trust
  Fund under the PFMRP.

- The Law on State Securities was passed by the National Assembly on November 30, 2006 and promulgated on January 10, 2007. The purpose of this law is to provide a framework for effectively printing/issuing and managing state securities in order to guarantee obligation of settlement/payments in terms of the state's financial requirements. The state securities may be printed either in local currency or foreign currency.
- On February 26, RGC Sub-decree #14 applied to the Joint Procedures of Implementing Cooperation Financing Project from the WB and ADB: i) Joint Standard Operating Procedures, ii) Joint Financial Management Manual, iii) Joint Procurement Manual.
- The Government's PFMRP is continuing to yield results. Following on from achievements in 2005 and 2006, a second wave of major reform measures was initiated in January 2007, including: i) a far-reaching streamlining of budget execution procedures to speed disbursements to spending agencies, ii) the introduction of program budgeting to better align spending with priority National Strategic Development Plan objectives, and iii) adoption of a new chart of accounts to improve expenditure reporting. All of these measures will improve the efficiency of the PFM system as well as reduce the fiduciary risk inherent in the system by reducing the threat of corruption.
- Macroeconomics-model developed and training provided. MEF is discussing with ADB for further
  assistance to add on features that enable it to integrate the use of this model into the budgetary cycle
  (macro-fiscal framework model). Meanwhile the Government Financial Statistics classification is being
  developed and applied in the State Budget Implementation Table (TOFE).
- The 2007 Budget Document, for the first time, contained details of donor-financed capital spending by line ministries; payment of taxes through the commercial banks has been trialled (Acleda Bank) and will be extended soon to the ANZ Royal Bank.
- 19 line ministries have established internal audit departments of which seven are operational.
- These are some progresses of Performance Indicators in the PFMRP: i) revenue out-turn increasingly close to targeted level in approved budget; ii) no accumulation of new arrears and steadily declining arrears stock; iii) budget holders increasingly able to commit expenditure in line with budgets and cash flow forecasts; iv) 75% of payments to creditors and staff made through the banking system in 2006; v) 45% of tax revenue collected through banks in 2006; vi) service delivery units (schools, health centers) receive an increasing proportion of funds targeted at their levels; vii) public procurement based on clear rules, consistently enforced and with no major delays in processing and payment; viii) composition of expenditure by type (staff costs, non-staff costs, etc.) close to approved budget; ix) better yield achieved from tax base through improved collection efficiency and planned use of non-tax sources; x) single

orderly budget process producing good (and integrated) budget plans, Budget Document for 2007 integrates recurrent, capital and donor-financed expenditure plus data for government-owned agencies; xi) all significant areas of both public revenue and expenditure captured in both the budget and accounts of the Government; xii) clearer/more accurate overview of public finances (TOFE) regularly available based on improvements in the existing system pending introduction of the FMIS. TOFE submitted to senior management within two weeks of end of period. Quarterly review of TOFE by Internal Audit Department found to be accurate; xiii) system in place to ensure that proposals for post-budget supplementary expenditure credits are always accompanied by MEF report on realistic options for financing the expenditure involved. No spending proposals go forward without identification of source of funding/offsetting savings; xiv) institutionalized mid-year budget review feeding into second half-year budget implementation/budget preparation for next year. Clear evidence that the review was conducted, formalized and effective, and results implemented; xv) Annual forecasts of all inflows and outflows prepared and regularly updated (based on accurate revenue forecasts and good budget implementation plans). Cash released to spending agencies within plus or minus 5% of their quarterly cash flow forecasts, to improve fiscal decentralization in a robust, controlled and measured way.

## Box A3.4: Cambodia Key Reforms in Public Administration/ Civil Service (2001-2007)

#### 2001:

- In October, the Government approved the remuneration policies which aim at rationalizing, motivating and retaining qualified civil servants.
- The Government introduced Human Resource Management Information System.
- In December, The Base Salary and the Allowances of Civil Servant issued by Royal Decree.

#### 2002:

- As a part of pay reform, the new remuneration and classification system was introduced.
- Pay reforms increased average salary from US\$19.5 per month in October 2001 to US\$28.1 in May 2002.

#### 2003:

• In February 2003, the Economic and Public Service Capacity Building Project (EPSCB) was introduced as an initial response to identified needs in core functions that are common to all ministries. The project targets three groups of public servants: the most senior executives; middle managers and technical staff in such areas as policy analysis; financial management and personnel management.

#### 2004:

- The Council of Administrative Reform (CAR) carried out six studies in order to rationalize the civil service: i) improving public service delivery, ii) benchmarking for labor market, iii) reviewing operations, iv) enhancing remuneration to support performance, v) enhancing employment to support service delivery, and vi) strengthening the management of the civil service workforce.
- On 15 January, the RGC increased index value of civil servant salary from CR 300 to CR 345 under Subdecree.
- In July, Public Administrative Reform became one of the four core reforms in the Rectangular Strategy of the RGC in its 3<sup>rd</sup> mandate.
- In August, the National Program for Administrative Reform (NPAR) was drafted. It is a competent and transparent public administration, able to deliver high-quality services to the people of Cambodia.

## 2005:

- NPAR phase I was completed. The key accomplishments include census and removal of irregulars, computerized personnel management and fiscal balance simulation
- A number of training courses and awareness seminars aimed at capacity building were conducted. As a
  result, the first Promotion of Management Development Programs (MDPs) and Professional
  Development Programs (PDPs), which are a part of the Economic and Public Sector Capacity Building
  Project (EPSCB), are completed.
- In early 2005, index value of civil servant salary was increased from CR 300 to CR 345. In August, the Government also increased functional allowances for middle and senior administration and priority sectors.
- Agreement reached between Treasury and CAR on use of private banking system to reduce cash transactions in the payment of salary.
- As a pilot, CAR and MEF agreed to establish the Priority Mission Group (PMG)/MBPI to cover an initial 300 centrally-located civil servants working on high priority PFM reform activities.

#### 2006:

• A strategy for phasing out salary supplementation practices was prepared through a collaborative process within the Technical Working Group (TWG) of Public Administrative Reform (PAR) based on Subdecree #98 of 2005. Its key achievements in 2006 were as follows: implementing of the approved sectoral action plans, PMGs and PMG/Merit based pay initiatives (PMG/MBPIs) in MEF, MOH, and at least one other ministry. PMGs covering 170 civil servants have been approved, with consultation ongoing on other possibilities, including in health sector. About 160 central office staff were proposed for an MBPI and

this proposal was discussed between HOM, the health partner, and CAR.

- The medium-term strategy and action plan to enhance remuneration, and the policy and action plan of redeployment, were developed and implemented in order to improve pay and employment conditions in the civil service.
- Designed and implemented Human Resource Management (HRM) policy and action plan to improve merit and performance management by introducing HRM guide and further developing HRM Information System (HRMIS) for the civil service.
- Enhanced service delivery through developing a one window offices (OWOs ) policy, legal framework and implementation plan. Five OWOs were established across Cambodia.

#### 2007:

• A meritocracy was introduced to encourage both wage reform and human capacity building within government ministries and institutions. These reforms result in public servants' remuneration increasing by 15% per year. The average salary of civil servants has now reached approximately US\$46 per month.

Source: Various Government Reports, EIC: Cambodia Economic Watch issue 1 to 6.

#### Box A2.5: Cambodia Key Reforms in Natural Resource Management (2001-2007)

#### 2001:

- On January 21, Community Fisheries Development Office established by Prakas #084 of MAFF.
- On July 20, Land Law adopted by the National Assembly on July 20, 2001 and promulgated on August 30.
   It provides legal protection to establish the security of land tenure and also a fundamental basis for the reduction of land disputes.
- On July 20, the draft Forestry Law containing 18 chapters and 109 articles was approved by OCM and officially submitted to the National Assembly on 17 August.
- During 2001, Government also issued a note about stopping illegal possession and a set of Prakas regarding service fees for land registration.
- On December 13, Prakas #5721 to suspend all logging activities by the government of Cambodia issued.

#### 2002:

- In May, to accompany the implementation of the Land Law, and provide guidance in the land sector, the Council of Land Policy approved an Interim Land Policy Framework document.
- Ministry of Land Management, Urban Planning and Construction (MLMUPC) prepared several subdecrees to enable the effective implementation of the Land Law. Sub-decrees adopted by the Government of Cambodia in 2002 included i) Organization and Function of the Cadastral Commission, ii) Systematic Registration, and iii) Case-By-Case Registration.
- Supported by the WB, MLMUPC created the Land Management and Administrative Project, effective in June.
- On July 26, the Government issued The National Policy for Forestry.
- On July 30, Forestry Law adopted by the National Assembly and promulgated on August 31.

#### 2003:

- On February 18, Inland Fisheries Research and Development Institute (IFReDI) inaugurated. Established
  in order to provide scientific information through research and development capacity for freshwater
  fisheries in Cambodia.
- On March 07, Sub-decree on Social Land Concession issued.
- Council of Land Policy established as focal point to facilitate the formulation of strategy and policy in land management.
- On September 11, Department of Forestry renamed the Forest Authority by Sub-decree #64. It has a horizontal management structure nationwide to undertake policy reform of the forest sector.
- On December 15, Sub-decree on Forest Community Management adopted.

#### 2004:

- RGC disclosed the location and legal status and process for termination of mining concessions, Military
  Development Zones, economic land concessions and other development arrangements situated on forest
  land or in protected areas and inconsistent with law governing management of these areas.
- On June 9, Prime Minister's Order #01 on prevention, repression and elimination of forest clearing, bulldozing, grabbing and fires, issued.
- National committees and sub-national committees at the provincial level established to implement the Order #01.
- The Council for Land Policy, in collaboration with development partners set up the Land Allocation for Social and Economic Development (LASED).

# 2005:

- On April 1, Sub-decree #53 on Establishment, Classification and Registration of Permanent Forest Estates issued.
- · On August 14, Decision #28 on establishment of Control and Evaluation Committee to Stop

Encroachment on Inundated Sea Forests, Land Leveling and Land Filling Along Seaside issued.

- In late 2005, Sub-decree on State Land Management, sub-decree on Economic Land Concession, and Sub-decree on Managing State Owned Land passed by OCM.
- On May 29, Royal Decree #0505/240 on the Establishment of Fishing Community issued.
- On June 10, Sub-decree #80 on management of Fishing Community issued.
- On May 20, Sub-decree on Community Fisheries approved by OCM.

#### 2006:

- On February 26, Land Dispute Agency established by Royal Decree, with members from both the Government and the opposition party.
- On March 30, Fishery Law adopted by the National Assembly and promulgated on May 21.
- In May, Royal Decree on Community Fisheries Establishment issued; followed by an issuance of a Subdecree on the Community Fisheries Management in June 2006
- In May, the National Community Forestry Programme Strategic Paper. It stipulated the Government's plan to offer formal recognition to the already existing 274 Community Forestry sites and created an additional 200 to 400 formally recognized sites.
- In May, a Prime Minister's Order issued on the Prevention of Deforestation for Land Ownership addressed the issue of land grabbing
- On June 30, Decision #30 established Technical Secretariat and information on the Economic Land Concession made available to the public through MAFF website.
- In August, Sub-decree on the transformation of the Department of Fishery (DoF) into Fishery Administration.
- District State Land Working Group established to help provincial committee in State Land Identification and Mapping.

#### 2007:

 Marine conservation, a Ten-Year Action Plan for Coral Reefs and Sea-Grass has recently been adopted by MAFF.

Source: Various Government Reports, EIC: Cambodia Economic Watch issue 1 to 6

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