

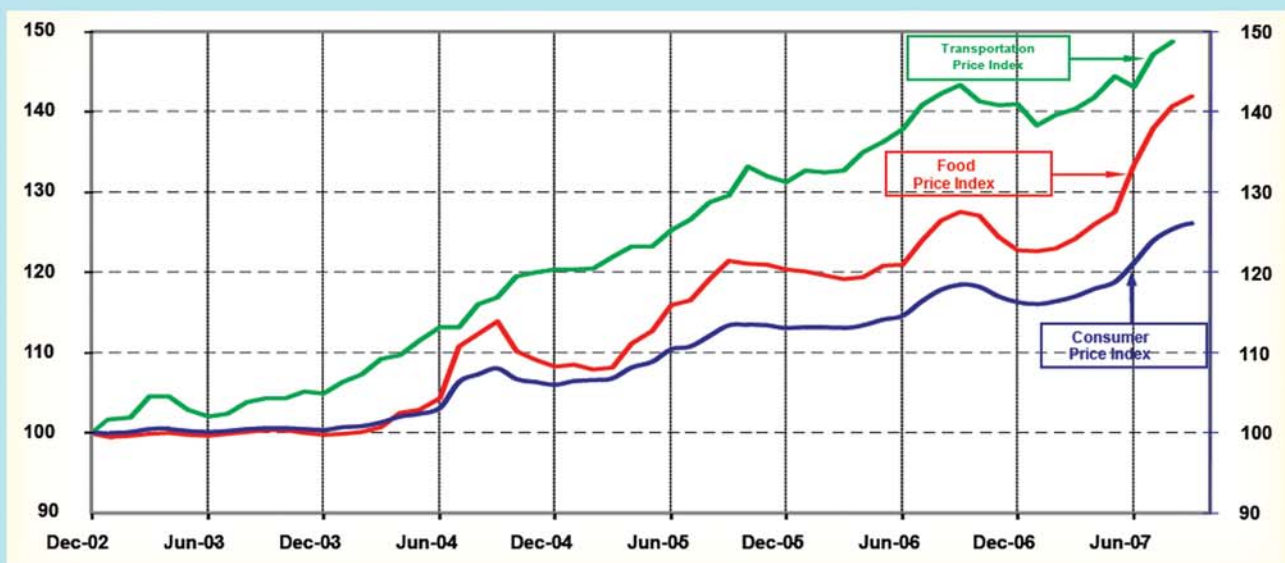


CAMBODIA

Economic Watch

October 2007

High inflation generally means lower economic growth, especially in service sector.





CAMBODIA

ECONOMIC WATCH

October 2007

ECONOMIC INSTITUTE *of* CAMBODIA

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LIST OF ABBREVIATIONS AND ACRONYMS

BSP	Budget Strategic Plan
CAMEX	Cambodia Stock Exchange Market
CAR	Council for Administrative Reform
CDC	Council for the Development of Cambodia
CDCF	Cambodia Development Cooperation Forum
CDRI	Cambodia Development Resource Institute
CIS	Credit Information Sharing
CLJR	Council for Legal and Judicial Reform
CMA	Cambodia Microfinance Association
CMDG	Cambodia Millennium Development Goals
COBRA	Cambodian Offsite Bank Reporting for Prompt Corrective Action
CoM	Council of Minister
CR	Cambodian Riel
CSOs	Civil Society Organizations
D&D	Decentralization and Deconcentration
EIC	Economic Institute of Cambodia
ELC	Economic Land Concession
EU	European Union
FMIS	Establishment of Financial Management Information System
FSDS	Financial Sector Development Strategy
GDCC	Government Donor Committee Coordination
GDP	Gross Domestic Product
HRD	Human Resource Development
HRM	Human Resource Management
HRMIS	Human Resource Management Information System
IFC	International Finance Corporation

ILO	International Labour Organization
IMF	International Monetary Fund
IRR	Internal Rule and Regulation
JMI	Joint Government-Donors Monitoring Indicators
MAFF	Ministry of Agriculture, Forestry and Fisheries
MBPI	Merit Based Pay Initiative
MDP	Management Development Program
MDTF	Multi-Donor Trust Fund
MEF	Ministry of Economy and Finance
MFI	Microfinance Institutions
MIS	Management Information System
MLMUPC	Ministry of Land Management, Urban Planning, and Construction
MoC	Ministry of Commerce
MoH	Ministry of Health
MoJ	Ministry of Justice
MoT	Ministry of Tourism
MTEF	Medium Term Expenditure Framework
NA	National Assembly
NBC	National Bank of Cambodia
NCDD	National Committee for D&D
NIS	National Institute of Statistics
NLA	National Authority
NLDA	National Authority for Land Dispute Resolution
NPAR	National Program for Administrative Reform
NSDP	National Strategic Development Plan
OWOs	One-Window Offices
PAP	Priority Action Programs
PDP	Professional Development Program

PFMRP	Public Financial Management Reform Program
PMG	Priority Mission Group
PPD	Public Procurement Department
RGC	Royal Government of Cambodia
RSM	Royal School of Magistracy
SAD	Single Administrative Document
SCM	Supreme Council of Magistracy
TWGFE	Technical Group on Forestry and Environment
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 in-depth 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.

Briefly, as expected at the beginning of the year, the updated data reveals that Cambodia continued to enjoy strong economic growth in 2007, expected to be about 8.5 percent. 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. Nonetheless, the Cambodian garment industry is currently facing huge challenges from Vietnam and a further threat from China in 2008.

It is worthy nothing that the current economic growth rate and the upcoming Cambodia Stock Exchange Market and the massif money exploited from the Extractive Industry such as oil and gas in medium term are attracting the attention of many big investors to Cambodia. The trend of private sector growth is seen as increasing and the government will get more massif budgets in medium term.

Whether Cambodia could benefit from such opportunity or not, would depends largely on the government, especially the reform progress. The reforms, together with effective anti-corruption policies, could provide a preferred environment and opportunity for higher economic growth. However, these reforms cannot be achieved in the short term.

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 inputs and comments, Miss 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

The revised data revealed that Cambodia's economic growth rate was 10.8 percent in 2006. The growth was mainly boosted by the continued expansion of garment exports, construction, and the number of tourist arrivals to Cambodia. It is worth noting that the growth was slowed-down from 13.5 percent in 2005 due to a significant slower growth in the agricultural sector, a slower growth of paddy. The growth of non-agricultural sector was about 13.1 percent in 2006, higher than the 12.6 percent in 2005.

The updated data available during the first nine months of 2007 reveals that Cambodia's economy remains well, especially the three growth-supported industries such as tourism, construction and garment industries. The growth of these sectors, however, is perceived to be at a slower rate, especially the garment sector. With no serious drought and inundation, EIC expects another high growth rate about 8.5 percent in 2007 for Cambodia, about 2 percent lower than that of 2006. The slower growth is mainly due to a slower growth of the garment sector, in addition to higher inflation during the year.

For 2008, garment exports are expected to continue their strong growth at a slightly slower pace, despite the approaching of the expiration of US and EU safeguards against China exports. Cambodia seems to be eligible to the US duty free under the US' New Partnership for Development Act. Number of foreign tourists in Cambodia is expected to continue its increase steadily. Residential construction is expected to continue growing at a somewhat slower rate. Other sectors are likely to keep the same trend as in 2007. If agricultural sector does not meet any serious problem as a result of severe drought or inundation, Cambodia would continue to enjoy high economic growth during the next few years at a slightly slower pace, expected about 8.0 percent for 2008.

Economic Growth by Sector

The agricultural sector is growing at a slower rate, expected at about 3.7 percent in 2007, down from 5.5 percent in 2006. The growth is mainly due to abundant rainfalls during the year, accompanied by the expansion of cultivated areas, high fish production, and continued increase of livestock production. The agricultural sector still be seen as a natural resource-based and remains largely depend

on geographical and unpredicted weather conditions. An effective irrigation system and natural resource management remain urgent measures needed for sustainable agricultural growth. The sector remains unpredictable.

In contrast, the industrial sector still maintains a strong performance, due to continued increase of the garment industry and construction. The industrial sector seems to realize another significant growth of 11.4 percent in 2007, about 7 percent lower than that in 2006. This slower pace mainly resulted from the slower increase of garment industry. The lower pace is expected to continue in the coming years because of the expiration of US and EU safeguards on China exports. The growth would be speeded up if Cambodia could get duty free to US.

Last but not least, the service sector also continued to achieve another high growth rate of about 10.0 percent in 2007, a slight decrease compared to the 10.3 percent growth in 2006. This is mainly due to an increase in number of foreign tourist arrivals in Cambodia and the significant increase in economic activity. However, the growth was partly shrunk by higher inflation during the period. The growth of the service sector remains strong in the coming years.

Balance of Payment

Total exports during the six months of 2007 increased by about 9 percent, about more than 10 percent lower than those of the same period in 2006. At the same time, imports also increased by 16 percent, 9 percent lower than those of 2006. As a result, the total trade deficit increased slightly in 2007, reaching about 14.7 percent of GDP. The widening of the trade deficit and the deficit of income balance create the deficit of the current accounts (including capital transfer), about 2 percent of the GDP, despite a significant increase of balance of services and surplus in transfer accounts.

The deficit is financed by foreign grants and loans, and foreign direct investment in Cambodia. Overall, the balance of payments for 2007 will be down to about 2.3 percent of the GDP, from about 3.4 percent in 2006. For 2008, the growth of external trade is expected to slow-down because of slower increase of Cambodia garment exports and slower growth of the importation of raw material used in the garment industry and construction. With the same phenomenon, the balance of payments for 2008 will expected to be about 2.8 percent of the GDP.

Besides, during the first seven months of 2007, The Council for the Development of Cambodia approved 58 investment projects which represented about US\$736.7 million of fixed assets. Compared to those of the first seven months of

2006, these investment projects decreased by 6 percent in terms of number of projects and 75 percent in terms of fixed assets. The most approved investment projects remain those of the garment industry, which accounted for 17 approved investment projects and US\$69.7 million of fixed assets. However, actual investment project keeps increasing given the approaching of Cambodian Stock Market and massif money exploited from oil and gas.

Price and Exchange Rate

Cambodia's inflation is reaching its peak in 2007 after slowing down in 2006. Compared to September 2006, inflation in September 2007 boosted up to 6.4 percent, mainly boosted by the 12.8 percent increase of the price of food. At the same time, the price of transportation and communication costs continued to increase at the slower pace of about only 2.0 percent in September 2007 compared to 11.2 percent in September 2006, because of a slower increase of oil price in the world market. Year-average of inflation is expected to be around 5 percent.

The riel appreciated against the US dollar by about 0.6 percent in July 2007 compared to July 2006; it went down to CR4,085 for one US dollar in July 2007 because of prudent monetary policy of the NBC, a significant increase in the amount of US dollars circulating in the market and a surplus of the balance of payments. With other currencies, the riel also slightly appreciated against the Vietnamese dong, but significantly depreciated against the Thai baht.

The total money supply reached CR9,088 billion in July 2007, a 47 percent increase from July 2006. In this period, foreign currency deposits continued to increase sharply by 58 percent, whereas local currency in circulation increased by only 15 percent. On the demand side, credit to the public sector continued to decline radically due to an increase in government deposits. Credit to the private sector also increased sharply by about 57 percent in July 2007 from July 2006.

Fiscal Development

During the first nine months of 2007, the central Government collected revenue of about 88 percent of the plan. The tax revenue reached 91 percent of the planned budget, while other revenues reached only 77 percent. This reflects the improvement in private activities. The revenue of the central Government is expected to get by 20 percent higher than that of 2006 and reaches 10.3 percent of GDP in 2007. This performance is expected to carry on in 2008, given the expectation of its good performance of economy. The central government revenue would reach about

CR4,013 billion in 2008 or 10.5 percent of GDP, higher than CR3,987 billion expected by the Government.

During the first eight months of 2007, the execution of the budget expenditure reached only 55 percent of the budget level. On average, spending on civil administration reached by 57 percent of the plan and that for priority ministries reached only 51 percent of the plan. A slow reporting process from line ministries may be a reason for the low figures. Nonetheless, based on previous trend, the total expenditure in 2007 is expected to reach the target, given a better revenue performance, and reached only 13.6 percent of GDP.

To sum up, the deficit reached CR157 billion, about 13 percent of what was planned in the budget law. Nonetheless, based on the previous trend, the budget deficit was expected about CR1,120 billion in 2007, represent about 3.3 percent of the GDP. The budget deficit is financed by international borrowing and assistance, of which external loans account for 60 percent.

It is worth noting that the public debt stock was revised to about US\$2.4 billion by the end of 2006, thanks to the reduction from US\$1,5 billion to US\$457 million of the debt owed to the Russian Federation. Reflecting to continued strong economic growth, public debt is on a sustainable path with the moderate risks.

Progress of Structural Reforms

NBC introduced COB-RA, a new software to analyze banks' documents, to develop its supervising capability. NBC also issued two Prakas, August 2007, related to risk management to the banks and instructed all banks and financial institutions to establish an internal control system of their foreign exchange risks.

After the launching of CIS system through a website in September 2006, this system is encountering some technical difficulties due to the small size of its server. The NBC plans to expand the CIS system to microfinance sector. Licensed MFIs will be able to share information of their clients' credit status once the CIS database system is stable and runs better.

Public Financial Management Reform Program has made substantial progress towards achieving the objective of the Platform 1, that is to have a more Credible Budget. Among others, the new calendar for budget preparation, the new accounting chart, and pilot-test of program budgeting, the establishment of international audit

departments and the expansion use of banking system would increase the credibility of the state budget.

However, putting all these new initiatives into practice still remains a challenge. The report on the implementation of the first semester of 2007 has been delayed and it is not certain to what extent these new initiatives such as program budgeting can be implemented effectively.

During the first half of 2007, an additional of six laws among the 46 committed with WTO requirements were promulgated. They are Criminal Code Procedure, Law on Water Resources Management, Law on Secured Transaction, Law on Land Traffic, Law on Customs, and Law on Government Security. However, progress in the legislative commitment has been slow.

In contrast, in the area of trade facilitation and private sector development, the government has made some remarkable progress. The progress included the improved institutional mechanism of Single Administrative Document which has resulted in reducing time required for investment approval, import and export processing, setting transparent tariff for public service provision as well streamlining the inter-ministerial procedures for goods inspection.

There is an improvement in the central administrative reform, especially the increment of civil servants' base salary and the development of relevant policies to strengthen human resources management practice as well as to enhance service delivery. Though there has been an increase on the average salary of the civil servants of 10 to 15 % annually in recent years, the current level of the average salary has just reached US\$52 per month which is still low by any standard.

The first draft of the Organic Law consisting of five volumes was completed in December 2006 and the consultation. However, up to day, the draft law is yet to be ready to be submitted to the National Assembly.

Law on Secured Transaction, Law on Water Resources Management and Criminal Procedure Code were adopted by The National Assembly and promulgated by the King. Many other laws and regulations are still yet to be finalized.

So far only the first two, Civil Procedure Code and Criminal Procedure Code, out of the eight fundamental legal texts have been accomplished. The remaining six other basic laws are still in the development process. For the Law on Anti-Corruption, the status is not clear, according to the report of the CLJR meeting on

June 2007, the Law on Anti-Corruption needs to be inline with the four codes and thus can only be completed after the completion of the four codes.

Concluding Remarks

Cambodia has enjoyed its strong economic growth during last decade, but the pattern of growth lead to a slower rate of poverty reduction and increase of inequality. Latest data showed that poverty rate in Cambodia has dropped from about 47 percent in 1994 to about 35 percent in 2004, only about 1 percent per annum. This reduction pace is perceived slower than 1.3 percent in Lao PDR or 3.2 percent in Vietnam, given its higher economic growth rate. At the same time, Gini coefficient increased from 0.347 in 1993 to 0.403 in 2004.

Nonetheless, it seems that the current economic growth rate and the upcoming Cambodia Stock Exchange Market and the massif money exploited from the Extractive Industry such as oil and gas in medium term are attracting the attention of many big investors to Cambodia. The trend of private sector growth is seen as increasing and the government will get more massif budgets in medium term. Boom in financial sector is also a good sign for expected boom in economic activities.

Whether Cambodia could benefit from such opportunity or not, would depends largely on the government, especially the reform progress. Thus, the speed of Cambodia's economic growth in next coming years and pace of poverty reduction will principally depend on the Government reforms. The reforms, together with effective anti-corruption policies, could provide a preferred environment and opportunity for higher economic growth. However, these reforms cannot be achieved in the short term.

Part I

Recent Economic Developments and Outlook

In 2006, Cambodia once again enjoyed a double-digit economic growth, this time at an expected rate of 10.8 percent, which comes after a 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 increase in tourists visiting Cambodia. This has put Cambodia as a top performer in the region in terms of economic growth rate compared to a 5.0 percent increase in Thailand, a 7.5 increase in Lao PDR, and an 8.2 percent increase in Vietnam. It was even slightly higher than China's 10.7 percent increase. However, the GDP per capita remained low compared to these countries.

In addition, another disturbing factor is the widening gap of inequalities. Estimates of the Gini coefficient, with geographically comparable areas, increased from 0.35 in 1993 to 0.4 in 2004. This wider gap is primarily caused by the disparity within rural areas where the Gini index rose from 0.27 to 0.33. This reflects difficulties faced by some of the poorer people living in rural areas in order to seize the opportunities offered by economic growth. Their inability to participate in the increased economic abundance is due to the fact that they remain voiceless and powerless as well as vulnerable to natural, economic and social external forces which can have a big impact on their lives.

The objective of this Economic Watch issue is to provide the latest estimated data on the country's economic growth in the first nine months of 2007 and prospects for the whole 2007 and 2008, and to detail the current progress of the Government's reforms. The pectoral growths of the economy are thoroughly analyzed by taking into account factors, both external and internal, to determine their growths. The country's other main economic areas such as movement in consumer prices, imports and exports, the execution of fiscal and monetary policies; income distribution and poverty are presented based on the most recent data. The identifiable progress of reforms is documented prior to the arguments, and some recommendations are then drawn upon for further discussions.

Chapter 1

Cambodian Economic Growth

The revised data revealed that Cambodia's economic growth rate was 10.8 percent in 2006. The growth was mainly boosted by the continued expansion of garment exports, construction, and the number of tourist arrivals to Cambodia; despite the consequences of an increase in the price of oil and other imported input costs. It is worth noting that the growth was slowed down from 13.5 percent in 2005 due to a significant slower growth in agricultural sector, a slower growth of paddy, even with favorable weather conditions during the year. By contrast, the economic growth rate, which excluded the agriculture sector, was about 13.1 percent in 2006, higher than the 12.6 percent in 2005.

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

	2003	2004	2005	2006	2007p	2008p
Agriculture	10.2%	-1.0%	15.5%	5.5%	3.7%	3.7%
Paddy	22.3%	-12.2%	43.6%	1.0%	1.0%	2.4%
Industry	12.4%	17.0%	12.9%	18.4%	11.4%	10.5%
Garments	16.8%	24.9%	9.2%	20.4%	9.4%	8.9%
Services	5.9%	13.3%	12.7%	10.3%	10.0%	9.1%
Tourism	-16.7%	23.4%	22.3%	13.2%	12.4%	12.1%
Total GDP	8.5%	10.0%	13.5%	10.8%	8.5%	8.0%
<i>Non Agriculture GDP</i>	7.7%	15.3%	12.6%	13.1%	10.5%	9.5%

Sources: NIS for 2002-2006, EIC Projection for 2007-2008.

As expected at the beginning of this year, the updated data available during the first nine months of 2007 reveal that Cambodia's economy remains well in certain sectors, especially the three growth-supported industries such as tourism, construction and garment industries. The growth of these sectors, however, is perceived to be at a slower rate, especially the garment sector. Also with no serious drought and inundation, and basing on the current economic trend and performance, EIC expects Cambodia to enjoy another high

growth rate about 8.5 percent in 2007, about 2 percent points lower than that of 2006. The slower growth is mainly due to slower growth of the garment sector, in conjunction with higher inflation during the year. The country's economic growth rate in 2007 remains strong compared to that of other countries in the region, but is slower than a 9.6 percent increase expected for China.¹

For 2008, the garment exports are expected to continue their strong growth at a slightly slower pace, despite the approaching expiration of US and EU safeguard measures to restrain China exports. Cambodia is eligible to the US duty free under the US' New Partnership for Development Act. Furthermore, the number of foreign tourist arrivals in Cambodia is expected to continue to increase steadily. The financial sector remains booming. The residential construction and real estate sectors are also expected to continue to grow at a slightly slower rate². Other sectors are likely to keep the same trend as in 2007. If, and only if, agricultural sector does not meet any serious problem as a result of severe drought or inundation, Cambodia should continue to enjoy high economic growth during the next few years at a slightly slower pace, beginning with an expected growth rate of about 8.0 percent for 2008.

Moreover, it seems that the upcoming Cambodia Stock Exchange Market (CAMEX) and the exploitation of the Extractive Industry such as oil and gas in medium term are attracting the attention of many big investors to Cambodia. Thus, Cambodia's economic growth could be speeded up if some critical reforms are seen in significant progress. Irrigation, renovation and natural resource management reforms are vital for agricultural growth. These reforms could reduce damage caused by weather conditions especially droughts, and could stop the decline of natural resources. Other reforms such as multi-faced reforms in trade and investment, in public finance, and in the legal and judicial system, are crucial for the development of the industry and service sectors. These reforms, together with effective anti-corruption policies, could provide a preferred environment and opportunity for higher economic growth.

¹ East Asia Update - March 2007, The World Bank.

² EIC survey.

1.1. Agriculture

The agricultural sector continues to grow at a slower rate, which is expected to be about 3.7 percent in 2007, a slight slow-down compared to the 5.5 percent in 2006. The agricultural growth should thanks mainly to abundant rainfalls during the year, accompanied by the expansion of cultivated areas, high fish production, and continued increase of livestock production. Thus, the agricultural sector is still seen as a natural resource-base and depends largely on geographical and unpredictable weather conditions. An effective irrigation system and natural resource management remain urgent measures needed for sustainable agricultural growth as well as poverty reduction because this sector is the main source of income of the poorer inhabitants. Based on current situation, growth prospected for the next coming years is still slim, being expected at about 3.7 percent in 2008, the same as that of 2007.

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

	2003	2004	2005	2006	2007p	2008p
Paddy	22.3%	-12.2%	43.6%	1.0%	1.0%	2.4%
Other Crops	21.5%	9.5%	12.4%	10.6%	8.2%	6.7%
Livestock	5.7%	3.9%	5.6%	8.2%	7.5%	6.6%
Fishery	1.7%	-1.7%	5.6%	3.8%	0.8%	0.8%
Rubber & Forestry	-3.8%	-0.3%	3.5%	6.6%	1.3%	1.2%
Total Agriculture	10.2%	-1.0%	15.5%	5.5%	3.7%	3.7%

Sources: NIS for 2002-2006, EIC Projection for 2007-2008.

For crop production, the weather conditions in 2007 are expected to be as favorable as the last two years' and cultivated areas keep increasing. However, crop productivity per hectare remains low and stable, especially paddy which is about 2.5 ton per hectare in 2006 and 2007. As a result, paddy value added is expected to slightly increase about 1.0 percent in 2007, the same pace as the increase in 2006, while the growth of other crops will continue with a slower rate of about 8.2 percent compared to the 10.6 percent increase in 2006. Effective irrigation systems remain urgent measures needed for the growth of crop production in coming years and the reduction of unexpected risk from the weather. The growth for crop sector is expected to continue to slow down.

The livestock sector still grows at a significant rate and is expected to be at 7.5 percent in 2007, down from the 8.2 percent in 2006. This is mainly due to the rapid increase of urban income and the tourism sector. However, investment in the area remains short and accessibility to credit is still limited, especially in the rural sector. Thus, large scales of livestock for domestic consumption are still imported from neighbor countries, especially Vietnam and Thailand. Based on the current trend, the growth rate of livestock production for the next few years remains moderate; it is expected to be about only 6.6 percent in 2008. As livestock is a potential income source for farmers beside their incomes from unpredictable crop cultivations, the government should be more active to promote this sector.

Fishery production remains high in 2007, similar to that of 2006. In 2007, the fish production decreased slightly in commercial and industrial fishing, but increased significantly in family fishing and slightly in rice field and marine fishing³. The fishery's value added is expected to grow slightly, about 0.8 percent in 2007, following a 3.8 percent increase in 2006. However, the number of illegal fishing complaints, the use of illegal fishing instruments and the destruction of essential fish rearing areas, remain important concerns if the sector is to grow in a sustainable manner. Thus, the prospect of the reemergence of fish stock in the coming year is still slim, only about a 0.8 percent increase expected for 2008.

Regarding other agricultural sectors, the growth prospected is still slim. The forestry sector growth is expected to be about 1.6 percent in 2007, down from 7 percent in 2006. Besides, rubber growth is negative despite rubber price increase in the world market. This is because old-rubber trees were cut and were replaced by the planting of new-rubber trees, which are still young to provide the raw rubber. The trend is expected to carry on in 2008.

1.2. Industry

In contrast to the agricultural sector, the industrial sector still maintains a strong performance. This strong performance is due to exceptional performance of the garment industry and the current

³ First semester 2007 report of MEFF

expansion of the construction sector. For 2007, the industrial sector is expected to realize another significant growth of 11.4 percent, about 7 percent points lower than that in 2006. This slower growth is mainly due to the slower increase of exports of garment products, the slower growth rate of construction, electricity, and gas and water industry, together with the moderate growth of other industries. This trend will continue in the coming years, it is expected to be about 10.5 percent in 2008.

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

	2003	2004	2005	2006	2007p	2008p
Garments	16.8%	24.9%	9.2%	20.4%	9.4%	8.9%
Food, Beverage & Tobacco	4.7%	-5.3%	9.0%	3.3%	5.8%	5.5%
Other Manufacturing	2.9%	7.5%	16.1%	13.9%	9.1%	7.7%
Electricity, Gas and Water	9.2%	11.2%	12.6%	31.0%	12.4%	11.2%
Construction & Mining	11.5%	13.7%	22.3%	19.7%	18.0%	16.0%
Total Industry	12.4%	17.0%	12.9%	18.4%	11.4%	10.5%

Sources: NIS for 2003-2006, EIC Projection for 2007-2008.

The Cambodia garment industry, the industrial sector's main contributor, remains strong in 2007, but grows at a slower pace due to increase in international competition in the global market, mainly that of Vietnam. During the first six months of 2007, the pieces of garment export to the US market continued to increase at a slower rate, about 16.5 percent compared to the 34.3 percent increase in 2006, while exports to the EU market decreased slightly during the same period. At the same time, the overall price of garment products in the world market keeps decreasing.⁴ Thus, globally Cambodia's garment industry growth rate is expected to slow down to about 9.4 percent in 2007 compared to a 20.4 percent increase in 2006.

For 2008, the garment industrial growth will continue at a slower pace with the slower growth their investors in 2007 and the validation of safeguarding measures of EU and US against China exports until the end of the year. The growth prospected for garment

⁴ Compiled from Ministry of Economy and Finance (MEF)

industry remains strong,⁵ expected about 8.9 percent in 2008. Nonetheless, the growth prospected for the Cambodian garment industry is very slim in the next coming years since the existence of safeguarding measures against China's exports is expected to expire at the end of 2008. Rising competitors such as China as well as Vietnam would be a big concern for the Cambodian garment industry because Cambodia is seen as weak in term of international competitiveness compared to these countries.⁶

However, the Cambodian garment product already created its niche market by positive evaluation of the labor compliance project monitored by the International Labor Organization (ILO). Together with efforts of the Government to reduce bureaucracy in transaction export, such as one Window Service, and the World Trade Organization (WTO) membership, Cambodia seems to be able to keep its big clients/buyers in US and EU.⁷ In total, the Cambodian garment industrial growth will follow the trend of global demand in the coming years. Nonetheless, the growth could be speeded up if, and only if, Cambodia could get the US duty free under the US' New Partnership for Development Act.

For the construction sector, growth remains strong. This should be due to the groups who benefit from the recent economic growth and impressive credit provided by the commercial banks. A significant increase in flats and apartments keeps going, despite slower growth rate in the garment factory and hotel construction. The growth rate for the construction sector is expected to be at 17.4 percent in 2007, only about 2 percent lower than that of 2006. An EIC survey on the construction of flats and apartments reveals an increase for the next coming years, but at a slightly slower rate. Thus, the growth for the construction sector remains strong in 2008; it is expected to be about 15.3 percent.

The expected growth of other industrial sub-sectors such as food, beverage and tobacco is growing at a faster rate because the depreciation of the riel against Thai baht increased the competitiveness

⁵ Based on GMAC chairman, purchasing order for Cambodia garment products remains strong in 2008.

⁶ World Economic Forum report 2005-2006

⁷ Cambodia Economic Watch April 2006

of local products against those imported from Thailand. But the growth rate is still moderate and expected to be about 5.8 percent in 2007, given that a slower growth rate on agricultural sector and investment in the sector remains limited. Growth in electricity, gas, water and other manufacturing sectors for 2007 keeps relatively the same rate as that of 2006. Growth prospected for these sectors is still moderate in coming years. The growth may be speeded up if there is a significant reform progress in some critical areas such as multi-faced reforms in trade and investment, in public finance, and in the legal and judicial system.

1.3. Service

Last but not least, the service sector also continued to achieve another significant growth rate of about 10.2 percent in 2007. This is mainly due to an increase in the recorded numbers of foreign tourist arrivals in Cambodia and the significant increase in economic activity, especially trade, transport and communication, and the finance service. However, the service growth in 2007 was lightly slowed down from 10.8 percent compared to the increase in 2006. The slower growth mainly resulted from higher inflation during the year. Higher inflation means lower real income or lower purchasing power. The service activities are very sensitive to the fluctuation of population income. Based on current trend, the growth prospected for the service sector remains strong in the coming years, it is expected to be about 9.3 percent in 2008.

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

	2003	2004	2005	2006	2007p	2008p
Transport & Communication	2.8%	10.2%	13.3%	4.3%	4.6%	4.9%
Trade	3.7%	5.9%	8.5%	7.0%	7.5%	7.9%
Hotel & Restaurants	-16.7%	23.4%	22.3%	13.2%	12.4%	12.1%
Other Private Services	17.8%	19.3%	13.0%	14.6%	12.9%	10.7%
Total Private Services	6.5%	14.4%	13.0%	10.8%	10.2%	9.3%
Public Administration	-4.5%	-6.7%	5.9%	-1.3%	4.4%	2.0%
Total Services	5.9%	13.3%	12.7%	10.3%	10.0%	9.1%

Sources: NIS for 2003-2006, EIC Projection for 2007-2008.

The hotel and restaurant sector achieved a significant growth rate in 2007, due to the continued increase in the number of international tourist arrivals in Cambodia. The number of foreign tourist arrivals in Cambodia for the first six months of 2007 increased by 23.3 percent compared to the same period in 2006. Based on the trend and seasonality, the foreign tourist arrivals for 2007 will continue to increase by 21.0 percent, about 1.0 percent higher than that of 2006. Meantime, since fruits and food used in the hotel and restaurants are mostly imported from Thailand, their costs are also increased because of the depreciation of the dollar/riel against Thai baht. Finally, the hotel and restaurant sector is expected to continue its strong growth at a rate of about 12.4 percent in 2007, about 1 percent point lower than that of 2006. Nonetheless, the growth in this sector remains strong in the coming years; it is expected to be about 12.1 percent in 2008.

Because of the good performance of economic activities in 2007, especially in the garment industry and tourism, the growth rate of trade remains high, about 7.5 percent in 2007, up from 7.0 percent in 2006. In contrast, transport and communication increased at a lower rate for both 2006 and 2007, about 4 to 5 percent due to the significant increase of oil price. However, physical infrastructure remains limited, in particular roads' and railways'. Further rehabilitation and reconstruction of roads is still the most needed for bringing products to markets. This will open trading opportunities to remote areas of the country that are currently unable to access to outside markets. Increased mobility of people, goods and services will in turn create a positive circle of market dynamics. The growth trend of these sectors is expected to carry on for 2008.

The financial sector continued to increase steadily about 30.4 percent in 2007, a double increase compared to that of 2006 because of the increase in economic activities and bank trust. Real estate in 2007 is also expected to continue its strong growth rate, about 11.0 percent, compared to that of 2006, given expected growth in residential construction. Other service sectors continue their growth rate at a slower pace, but remain high; it is expected to be about 12 percent. Based on current trend and economic activities, the growth prospect for these sectors remains strong for the next coming years.

Chapter 2

Trade, Investment, and Productivity

The amount of Cambodia's external trade continues to increase significantly in 2007, but at a slower rate due to slower increase of activities related to the garment industry. The trade deficit keeps significantly increasing in 2007 compared to 2006, because of the increase in the price of imported oil, as well as other consuming products. However, the surplus of the overall balance of payments remains positive, but slight lower than that of 2006. Besides, fixed assets of private investment and worker productivities also keep increasing at a slower rate.

2.1. External Trade and Capital Movement

Compiling from the official data of Ministry of Commerce revealed that the total exports during the six months of 2007 increased about 9 percent, about more than 10 percent point lower than those of the same period of 2006. This reflects a slower growth in the export of garments and the export of agricultural products. In the same time, imports also increased by 16 percent, 9 percent lower than those of 2006. Imports of petroleum and raw materials, especially those related to the garment sector and construction, made up the lion's share of that figure. As a result, the total trade deficit is increased slightly in 2007, reaching about US\$1.2 billion in nominal terms, or about 14.7 percent of nominal GDP, up from 14.5 percent in 2006.

Due to the significant increase in the number of foreign tourist arrivals in Cambodia, the income generated from tourists' expenses (travel) is estimated to have reached about US\$1.2 billion in 2007, 21 percent up on 2006. Unfortunately, revenue from tourist transportation remained low, reaching only about US\$201 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 has improved significantly in 2007, up by 27.9 percent from 2006, and reaching 7.8 percent of GDP.

The income account for 2007 is estimated to be in deficit, about US\$351 million, up by 21 percent from 2006, and representing about

4.2 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 in the garment industry, as well as payments for foreign technical assistance by donors.

Table 2.1: Cambodia's Balance of Payments (Million of US Dollar)

	2003	2004	2005	2006	2007p	2008p
Exports of Goods	2,087	2,589	2,910	3,693	4,313	4,802
Imports of Goods	2,668	3,269	3,928	4,749	5,526	6,178
Trade Balance	-581	-681	-1,018	-1,056	-1,213	-1,375
Agriculture	258	179	350	401	461	527
Textiles & Garments	827	1,082	1,173	1,409	1,510	1,651
Oil & Gas	-428	-610	-842	-1,176	-1,391	-1,527
Other Goods	-1,239	-1,332	-1,698	-1,690	-1,793	-2,026
Balance of Services	114	291	471	506	648	862
Transportation	-157	-194	-233	-269	-309	-354
Travel	353	556	743	841	1,015	1,109
Others	-82	-72	-38	-65	-59	108
Balance of Incomes	-179	-221	-254	-290	-351	-368
Balance of Transfers	480	497	535	764	748	760
Private Transfers	153	176	209	315	332	334
Government Transfers	326	321	326	449	416	426
Current Accounts and Capital Transfers	-167	-115	-265	-76	-169	-121
Financial Accounts	244	219	335	321	358	373
Official Loans (net of amortization)	149	154	144	120	152	158
Foreign Direct Investment (FDI)	141	279	381	408	447	435
Others	-46	-214	-190	-206	-241	-221
Change in Foreign Reserves	77	105	70	246	190	252
At the National Bank (NBC)	74	70	109	185	108	113
Outside NBC	3	35	-39	61	82	139

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

At the same time, net private transfer is expected to increase by 5.3 percent; it reached US\$332 million in 2007. Combined with the large inflow of foreign assistance, Cambodia's transfers accounted for a

surplus of about US\$748 million, 9 percent of nominal GDP in 2007. As a result, the deficit of the current account, including capital transfers, is expected to be doubled in 2007 compared to 2006, accounted for about 2 percent of GDP.

Nevertheless, the surplus of financial account is expected to increase about 11.4 percent, reaching about US\$358 million or reaching 4.3 percent of GDP in 2007. Official loans and foreign direct investment contribute to this increase. To sum up, the surplus of the overall balance of payments in 2007 is expected to decrease to US\$190 million, or to about 2.3 percent of the GDP, down from about 3.4 percent in 2006. The NBC's foreign reserves are expected to increase by about US\$108 million in 2007, where as those held by other economic agencies as well as households will increase by US\$82 million. The trend is expected to continue in coming years.

For 2008, the growth of external trade (export and import) is expected to slower down because of slower increase of Cambodia garment exports, slower growth of the importation of raw material used in the garment industry and construction.⁸ In total, the trade deficit is expected to be widened, an expected about 13.4 percent increased from 2007, reaching about 14.8 percent of nominal GDP. The widening of the trade deficit and the deficit of income balance creates the deficit of current accounts including capital transfer of about 1.3 percent in 2008, despite a significant increase of balance of services and surplus in transfer accounts. The deficit was financed by foreign grants and loans, and foreign direct investment in Cambodia. Overall, the balance of payments for 2008 will expected to be about 2.8 percent of the GDP.

2.2. Private Investment and Stock of Capital

During the first seven months of 2007, the Council for the Development of Cambodia (CDC) approved 58 investment projects which represented about US\$736.7 million of fixed assets. Compared to those of the first seven months of 2006, these investment projects were decreased by 6 percent in terms of number of projects and 75 percent in terms of fixed assets. The most approved investment projects remain those of the garment industry, which accounted for 17

⁸ Beside, the cement could be produced in Cambodia.

approved investment projects and US\$69.7 million of fixed assets. This reflects the continuous high growth of garment exports.

Nonetheless, it is worth noting that the number of investment projects in the agro-industry remains limited in 2007 after significant increase during 2006. By comparison, fixed assets of the investment projects in the garment industry and hotels and restaurants increased moderately in the first seven months of 2007, reflecting significant growth projected for the garment and tourism sectors. The lower investment in the agricultural sector may result mainly from poor infrastructure and a limited pool of skilled labor.

Table 2.2: Approved Private Investment Projects

	2002	2003	2004	2005	2006	Up to July 2007
Number of Approved Investment Projects						
Total	37	66	60	104	99	58
Garment	16	31	35	53	49	18
Hotel	4	11	3	4	4	2
Others	17	24	22	47	46	38
Fixed Assets Approved (Million of US Dollar)						
Total	240	314	231	695	4,451	736
Garment	18	75	85	118	212	143
Hotel	47	114	23	65	22	33
Others	175	125	123	512	4,217	560

Source: CDC, Cambodian Investment Board,

(*)2005 and 2006 excluded registered investments of 3 mega-projects in oil refining, iron mining, and steel and aluminum smelting, the combined fixed assets of which are more than US\$3.5 billion & registered investment of the World City project, with US\$2 billion of fixed assets.

Regarding actual investment projects in 2007, the growth of investment in garment factories in 2007 remains high due to the validation of US and EU safeguard measures, but the pace is slower than that of 2006 due to an increase in competition from Vietnam. Investment prospected in the construction sector is still high in 2008, leading to significant increase of imported raw materials used for

construction. But given limited infrastructure development and a lack of skilled human resources, projected growth for the agro-industry is also flat. To sum up, the growth of investment projects implemented in 2007 will slow down compared to that of 2006, if many mega investment projects in 2006 are excluded. The investment projects will keep increasing in the coming years, given the approaching of Cambodian Stock Market and massif money exploited from oil and gas industry.

2.3. Productivity

Productivity is the key to increased competitiveness and building better businesses that are attractive to investors. According to an EIC estimate, the total productivity of workers (value-added per worker) in Cambodia increased about 5.8 percent per annum during the last decade, while real GDP growth rose by 9.6 percent per annum. This growth has allowed Cambodia to keep its competitiveness relatively strong.

The expected lower growth of agricultural production in 2007, mainly paddy production, has slowed the growth rate of its productivity. The labor productivity of agriculture in 2007 is expected to increase by only about 2.0 percent, which was down from 3.3 percent in 2006 and 13.0 percent in 2005. This was because the agricultural sector remains almost totally dependent on weather conditions. The key strategy to keep steady productivity growth is to invest in the irrigation system. Based on the performance of agricultural sector in 2008, the labor productivity is expected to increase by only 1.9 percent in 2008.

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

	2003	2004	2005	2006	2007p	2008p
Agriculture	7.7%	-3.1%	13.0%	3.3%	2.0%	1.9%
Paddy	19.3%	-14.2%	40.4%	-1.1%	-0.8%	0.9%
Industry	6.4%	7.5%	2.4%	6.3%	1.7%	2.5%
Textile & Garment	10.8%	9.4%	-0.7%	5.6%	-1.4%	0.4%
Private Services	2.3%	8.6%	4.6%	3.4%	5.8%	6.2%
Tourism	-14.3%	8.2%	7.9%	4.9%	4.6%	5.2%
Total (*)	6.2%	6.1%	9.4%	7.0%	5.3%	5.3%

Source: EIC Estimates

(*) Excluding Public Administration.

In the mean time, the productivity of the garment industry 2007 is expected to decrease by about 1.4 percent from that of 2006. This is because of a slower growth of garment product exports, despite growing learning experiences and additional trainings at the factory middle management level. Labor productivity of the construction sector is expected to increase significantly, while that of other industrial sector continues its growth with a moderate rate. In sum, labor productivity in industry continues to grow by only 1.7 percent, down from 6.3 percent in 2006. Based on the performance of industrial sector in 2008, the labor productivity is expected to increase by only 2.5 percent in 2008.

In contrast, the labor productivity in the service sector (excluding public administration) is continuing its increase with a faster rate of about 5.8 percent in 2007, up from 3.4 percent in 2006. This is largely due to the significant increase of labor productivity in tourism, real estate and the financial sector, and combined moderate growth of other service sectors. To sum up, the total annual worker productivity growth will slow down to 5.3 percent, reaching US\$1,077 per worker. Based on the economic performance in 2008, the growth of total labor productivity is expected to carry on with 5.3 percent and reach US\$1,134 in 2008, mainly supported by 6.2 percent increase in labor productivity in the private service sector.

Chapter 3

Price and Monetary Development

The growth of Cambodia's economy will be substantial if inflation and the Riel remain stable. Cambodia's inflation is reaching its peak in 2007 after slowing down in 2006 due to a significant continued increase in transportation and communication prices, and the increase in food prices. The Riel was relatively stable or slightly decreased against the US dollar because of prudent monetary policy of the NBC, a significant increase in the amount of US dollars circulating in the market and the surplus of the balance of payments. The trend is expected to continue for the coming year.

3.1. Inflation

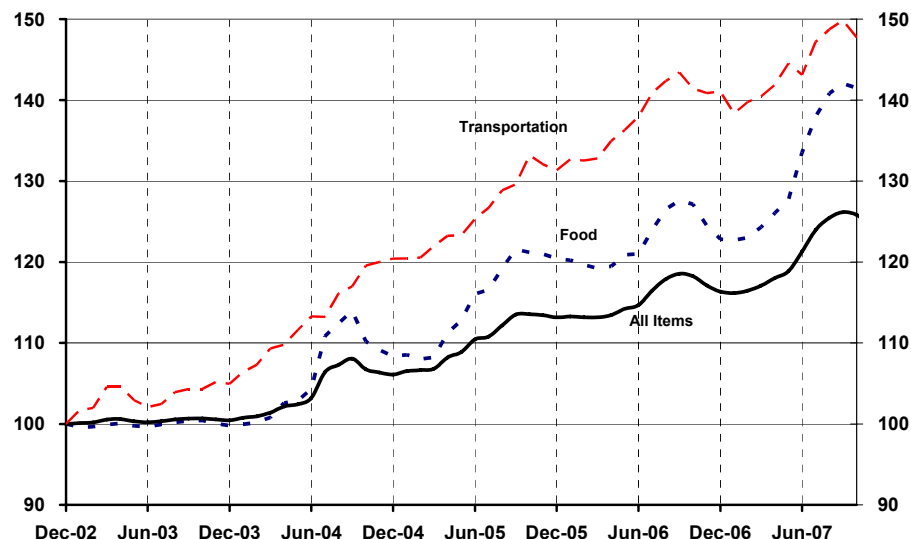
The inflation rate was slowed down to 2.8 in 2006 after the upward trend during 2003 and 2005, about 0.3 percent in December of 2003 to 6.7 percent December. The slower inflation of 2006 was mainly because of the slower growth in food prices, despite a continuous strong growth of the price of transportation and communication. Data for the first nine months of 2007 revealed that inflation in September 2007 has boosted up to 6.4 percent, higher than 4.4 percent of September 2006. In this period, the price of food rose about 12.8 percent in September 2007 compared to only 5.0 percent in September 2006. In contrast, transportation and communication costs continued to increase at a slower pace, about only 2.0 percent in September 2007 compared to 10.7 percent in September 2006.

Despite the almost full capacity used in the agricultural sector, especially crops, livestock and fish, food prices keep increasing significantly. This is because local production remains limited for domestic demand and some amounts are exported for higher international price. Thus, higher price of imported food, mainly from Thailand⁹, pushed up the price of food consumed in Cambodia considerably. The increase of the price of transportation has significantly slowed down mainly due to the slower growth of the price of gasoline. This is mainly caused by the slower increase in crude

⁹ Due to depreciation of the riel and US dollar against Thai baht

oil prices on the international market during that period. Other prices grew at a moderate rate.

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



Source: National Institute of Statistics.

Based on trends from previous years, the overall inflation in December 2007 compared to December 2006 is expected to be about 6.4 percent, which is much higher than that of 2006. This is about 3 percent higher than in Thailand and relatively the same as that in Vietnam.¹⁰ For the yearly average, Cambodia's inflation rate was 5 percent in 2007. Natural resource management for higher and sustainable growth of agricultural production and a stable exchange rate are crucial in order to reduce the inflation rate, and increase competitiveness of domestic products.

3.2. Exchange rate

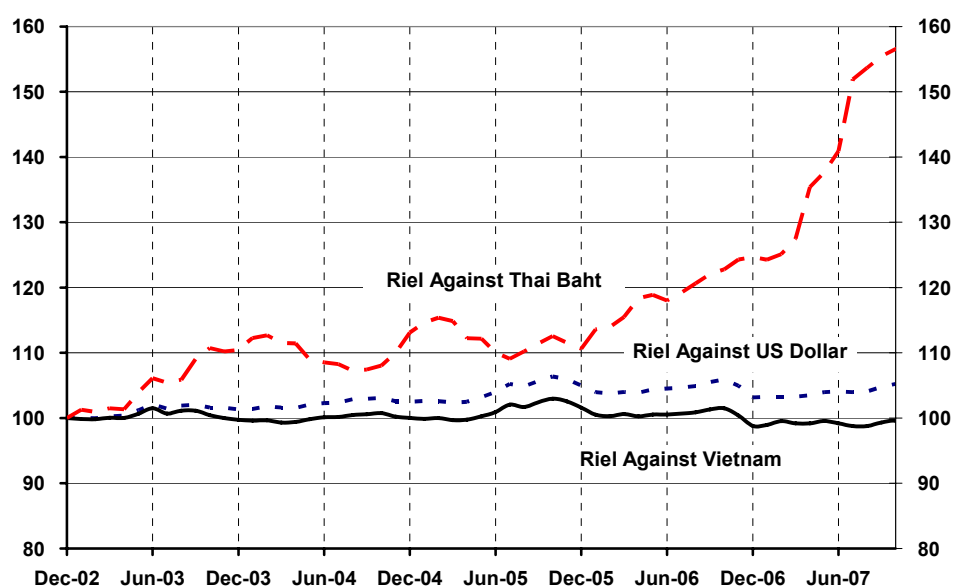
The riel keeps appreciating against US dollar gradually and varies slightly during the first seven months. The riel appreciated against US dollar about 0.6 percent in July 2007 compared to July 2006, or down to CR4,085 for one US dollar in July 2007. Prudent monetary policy of the NBC and surplus of balance of payment are the main reasons. The trend is expected to carry on for the whole year. The year-average exchange rate of the Riel and US dollar is expected at

¹⁰ East Asia Update - March 2006, The World Bank.

about CR4,081 for one US dollar in 2007, about 0.6 percent appreciated from that of 2006.

Together with prudent monetary policy of the NBC, the relative strength of the riel was partly a result of the significant expansion in economic activities in rural areas for the last three years -- especially activities related to agricultural products. The riel is largely used in the informal sectors which are mostly located in the rural and in some urban areas. In contrast, the slower growth expected in the agricultural sector, will lead to a slower increase in demand for the riel in coming years.

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



Source: EIC, Data compiled from the IMF and NBC.

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, expected strong demand for US dollars and shortage in their supply, as well as a slower increase in demand of riel will then

put some pressure on the riel against the dollar in 2008. Currency speculation during the election period could also reason in the depreciation of the riel in the coming years. Thus, a prudent policy of the government is important to maintain a stable exchange rate of the Riel against US dollar.

With other currencies, the riel also slightly appreciated against the Vietnamese dong, but significantly depreciated against the Thai baht. Official exchange rate showed that the riel appreciated against Vietnamese dong about 1.2 percent in July 2007 compared to July 2006, or down to VND3.97 for one riel in July 2007. At the same time, the riel depreciated 27.4 percent against Thai baht, trading around CR138 for one baht. The trend is expected to carry on over the year.

The depreciation of riel against Thai baht would benefit to Cambodians due to an increase of the competitiveness of Cambodian products, especially agricultural products, for both export products and local products compared to those of Thailand. However, such benefit remains slim since the capacity of Cambodian producers is almost rigid and limited, which is not sufficient even for local demand. This limitation has, instead, forced Cambodian consumers to use imported products, especially those from Thailand, with higher prices.

3.3. Money supply

The total of the money supply is continuing its strong increase during the first seven months of 2007. Total money supply (M2) reached CR9, 088 billion in July 2006, 31 percent increase from December 2006 and 47 percent increase from July 2006. This surge is still caused by an impressive increase in foreign currency deposits. Foreign currency deposits continue to increase sharply by 58 percent in July 2007 compared to July 2006, whereas local currency in circulation increased only 15 percent in the same period. As a percentage of GDP and based on current trends, the total money supply is expected to reach 30 percent in 2007, which is a slight increase compared to the 23 percent in 2006.

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

	2002	2003	2004	2005	2006	July 07
Total Money Supply	2,888	3,329	4,329	5,025	6,942	9,088
Local Currency in Circulation	766	908	1,115	1,282	1,600	1,683
Foreign Currency Deposits	2,001	2,310	3,079	3,589	5,196	7,246
Other Liquidity	122	111	135	153	147	160
Total Money Demand	2,888	3,329	4,329	5,025	6,942	9,088
Credit to Private Sector	1,059	1,337	1,817	2,394	3,628	4,889
Credit to Public Sector	-117	-128	-209	-421	-951	-1,443
Other Money Demand	1,947	2,120	2,721	3,052	4,266	5,642

Source: NBC

In sum, money in 2007 continues to be dominated by foreign currency, representing about 80 percent of the total money supply and 24 percent of GDP, while Riel liquidity remained limited, representing about only 18 percent of the total money supply and only 5.5 percent of the GDP. The growth in foreign currency reflects the strong activity in sectors such as tourism and garments. However, a large amount of foreign currency, especially the US dollar, was sent to their respective countries by many big foreign investors in Cambodia, and our country's banking system is limited.

On the demand side, credit to the public sector continued to decline radically due to an increase in government deposits and especially IMF's debt relief. Credit to the private sector also increased sharply about 57 percent in July 2007 compared to July 2006 and 35 percent compared to December 2006. This credit expansion was the result of lower interest rates in 2007 compared with 2006, the growths in the manufacturing, construction, and service sectors, and the expansion of the private banking system. These trends are expected to carry over into 2007, but at a slightly lower pace. The credit to private sector will reach 17 percent of the GDP in 2007, up from 12 percent in 2006.

3.4. Interest rate

With gradually rising confidence in the financial system and economic expansion over the last decade, both deposit and lending rates

in riel decreased slightly on a regular basis. However, the average interest rate on 12-month deposits and loans in riel seemed to have slightly increased to 6.5 percent and 23.2 percent in July 2007 from 6.4 percent and 23.1 percent in December 2006, respectively.¹¹ This slight increase resulted from a shortage of the loan credit in riel to respond to its increasing demand, especially in the rural area, given favorable climate condition during the last three years.

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

	2003	2004	2005	2006	June 07
Riel 12-months Deposits Rate	7.0	6.6	6.8	6.4	6.5
US\$ 12-months Deposits Rate	4.0	3.7	4.0	4.8	4.9
Riel 12-months Lending Rate	21.1	18.7	18.6	23.1	23.2
US\$ 12-months Lending Rate	17.3	16.7	16.2	16.7	16.6
Inflation rate (yearly average, in riel)	1.2	3.9	5.6	4.7	-
Inflation rate (yearly average, in US\$)	-0.1	2.8	3.6	4.1	-

Source: NBC and NIS.

On the other side, the average of interest rates of a 12-month deposit in US dollar continued to increase gradually to about 4.9 percent in July 2007, up from 4.8 percent in December 2006. Nevertheless, the average of interest rate of 12-month loans decreased slightly to 16.6 percent in July, down from 16.7 percent in December 2006, due to increase in competition among the commercial banks in providing the credits in recent years.

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

¹¹ NBC

unavailable for lending to local borrowers. In contrast, most of the credits for local borrowers come from overseas. Thus, 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 are unable to benefit from the economic growth. Lower interest rates would encourage them to invest, thereby contributing towards economic growth in rural areas.

Chapter 4

Fiscal Development and External Debt

In recent years, the Government showed significant improvement in the implementation of the state budget regarding what has been planned. The amount of Government revenue increased about 20 percent a year. However, this amount remained relatively stable 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. Cambodia's debt situation remains on a sustainable path with moderate risk of debt distress.

4.1. Budget Revenue

For 2007, the central Government has planned to raise its revenue to CR3,282 billion, or reach about 10.92 percent of nominal GDP of 2007 expected by the MEF. The main source of that revenue will remain taxation, which is expected to account for about CR2,682 billion, representing around 82 percent of total revenue, and 18 percent more than what was received in 2006. Besides, other sources of state income, non-tax revenues, represent only about 18 percent. The non-tax revenue should be strengthened due to the expected decline in the share of Trade Tax (import duty), because of trade liberalization, which is one of the most important sources of national budget revenue.

During the first nine months of 2007, the central Government collected revenues which amounted to CR2,873 billion, representing 88 percent of what the Government had planned. The tax revenue reached 91 percent of the planned budget, while other revenues reached only 77 percent of the planned budget. However, there were significant improvements in the collection of tax on income, profit, and capital gain, of which more than 90 percent of the plan was implemented. This reflects the improvement in private activities. The duties on export quotas reached 168 percent of the plan. Unfortunately, revenue collected from import tax and duties of oil products was below the target.

Given the good performance of economic activity in 2007 and the previous trend, the revenue collection of the Government is expected to

meet the target and even higher, thanks to the improvement in tax collections. It is expected by 20 percent higher than that what implemented in 2006 and reaches 10.3 percent of the current estimated GDP of 2007. This performance is expected to carry on in 2008, given the expectation of high performance of economic activities in the period. Based on the trend and expected economic performance, the central government revenue would reach about CR4,013 billion in 2008, higher than CR3,987 billion expected by the Government¹², or 10.5 percent of the GDP.

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

	2003	2004	2005	2006	2007p	2008p
Total Domestic Revenues	1,765	2,127	2,626	2,918	3,500	4,013
Tax Revenues	1,220	1,577	1,911	2,271	2,810	3,197
Profit Taxes	110	117	172	262	360	411
Excise Taxes	198	304	380	418	510	568
Value Added Taxes	460	598	730	870	1,070	1,190
International Trade Taxes	395	513	573	645	780	929
Other Tax Revenues	57	44	56	76	90	100
Non-tax Revenues (1)	545	549	715	647	690	816
Tourism Activity (2)	83	118	160	190	224	262
Quota Auctions & Export Licenses	146	76	123	123	123	123
Posts & Telecommunication	120	94	123	83	75	101
Other Non-tax Revenues (1)	196	261	310	251	268	330
Memorandum Items						
<i>Taxes From Petroleum Products</i>	<i>445</i>	<i>442</i>	<i>461</i>	<i>525</i>	<i>577</i>	<i>630</i>
<i>Tax Department Revenue</i>	<i>345</i>	<i>405</i>	<i>556</i>	<i>727</i>	<i>980</i>	<i>1,126</i>
<i>Customs Department Revenue</i>	<i>875</i>	<i>1,173</i>	<i>1,355</i>	<i>1,544</i>	<i>1,830</i>	<i>2,071</i>

Sources: MEF for 2003-2006, and EIC for 2007-2008.

(1) Including Capital Revenue

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

However, there are some possibilities to further improve revenue collection. More effective measures have to be taken to

¹² The Government planned the budget revenue based on the assumption of 7 percent expected for the GDP growth in 2008 and 4 percent for yearly average inflation.

enforce the Law on Taxation, to extend the tax base on the informal sector, and especially to strengthen the tax audit to reduce revenues lost by corruption. Furthermore, the anti-smuggling plan should be strengthened at each border check point because large scale smuggling continues, especially that of petroleum, due to the high tax imposed in Cambodia compared to neighboring countries.

4.2. Budget Expenditure

Regarding the expenditure side, the central Government expects to expand about CR4,620 billion in 2007, which represents an approximately 12 percent bigger spending than that of 2006. Compared to 2006'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 expenses 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 CR980 billion, a 24 percent increase on 2006.

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

	2003	2004	2005	2006	2007p	2008p
Total Expenditure	2,757	2,962	3,182	4,112	4,620	5,472
Current Expenditure	1,586	1,769	1,967	2,592	3,020	3,612
Civil Administration	1,175	1,346	1,516	2,072	2,400	2,864
Priority Sector	529	573	644	791	921	1,120
Other Civil Ministries	646	773	872	1,281	1,479	1,743
Defense & Security	411	423	451	520	620	749
Defense	270	272	289	344	444	535
Security	141	151	162	176	176	214
Capital Expenditure	1,171	1,193	1,215	1,520	1,600	1,860
Through National Treasury	333	296	315	379	380	493
Direct External Financed	838	896	900	1,141	1,220	1,366
Memorandum Items						
Wages	615	640	711	822	980	1,166
Non-Wages Operating Costs	971	1,130	1,256	1,770	2,040	2,446

Sources: MEF for 2003-2006, and EIC for 2007-2008.

During the first eight months of 2007, the execution of the budget expenditure reached only 55 percent of the budget level; 55 percent and 56 percent of the plan had been implemented for current expenditure and capital expenditure, respectively. On average, spending on civil administration reached by 57 percent of the plan, while that on defense and security implemented by 64 percent of the plan. Budget disbursement for priority ministries also reached only 51 percent. A slow reporting process from line ministries may be a reason for the low figures.

Nonetheless, based on previous trend, the total expenditure in 2007 is expected to reach the target, given a better revenue performance. As shared to GDP, total expenditure of 2007 reached only 13.6 percent, slight decrease from 13.8 percent of 2006. Budget disbursement as a share of GDP for priority sectors may reach 2.3 percent and with a slight increase for wages. Based on current trend and performance, budget disbursement for 2008 is expected to increase to CR5,472 billion, slightly lower than CR5,553 billion expected by the Government. Public good deliveries remain limited, particularly for soft and hard infrastructure as well as irrigation for the agricultural sector, to correspond to Cambodian needs.

4.3. Budget Financing and External Debt

The amount of budget revenue remains low compared to that of expenditure. During the first nine months of 2007, the deficit reached CR157 billion, about 13 percent of what was planned in the budget law. Lower expenditure with good revenue during the period is the main reason for this low deficit. Nonetheless, based on the previous trend, the budget deficit was expected to jump back to about CR1,120 billion in 2007, about 0.6 percent point decrease from that in 2006. As a percentage of the GDP, the deficit in 2007 is expected to be about 3.3 percent, lower than 4 percent in 2006. The budget deficit is mainly financed by international borrowing and foreign assistance, of which external loans account for about 60 percent, Cambodia having to avoid domestic debt financing.

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

	2003	2004	2005	2006	2007p	2008p
Total Domestic Revenue	1,765	2,127	2,626	2,918	3,500	4,013
Total Expenditure	2,757	2,962	3,182	4,112	4,620	5,472
Total Deficit (cash basis)	-992	-835	-556	-1,194	-1,120	-1,459
Foreign Financing	886	894	984	1,584	1,280	1,459
Grants	382	372	538	790	430	450
Loans (net)	504	522	446	794	850	1,009
Domestic Financing	106	-59	-428	-390	-160	0
Banks	-3	25	-199	-333	-160	0
Others	109	-84	-229	-57	0	0
Memorandum Items						
<i>Net Foreign Reserves at NBC</i>	2,532	2,836	3,336	4,400	4,832	5,283

Sources: MEF for 2003-2006, and EIC for 2007-2008.

The public debt stock was revised to about US\$2.4 billion by the end of 2006, thanks to the reduction from US\$1.5 billion to US\$457 million of the debt owed to the Russian Federation. As percentage to nominal GDP, the public debt accounted for about 33.2 percent in 2006, down from about 37.1 percent in 2005. Based on Joint IMF/World Bank Debt Sustainability Analysis 2007, the ration debt to GDP is expected to further decline in 2007. External debt constitutes about 95 percent of public debt and about 35 percent of the external debt was owed to the Russian Federation and the United States.¹³

Reflecting to continued strong economic growth and the highly concessional structure of Cambodia's lending, debt is on a sustainable path. However, its moderate risks do remain, particularly given the current low level of government revenues, the continued existence of external arrears and the potential for contingent liabilities. If Cambodia reaches debt rescheduling agreements with the two creditors and begins servicing debts in 2007, the risk of debt distress will decline further, though low revenue collections will continue to pose risks to debt sustainability.¹⁴

¹³ IMF, Cambodia 2007 Article IV Consultation

¹⁴ IMF, Cambodia 2007 Article IV Consultation

Chapter 5

Labor Force, Incomes, and Poverty

5.1. Employment

The latest data from the Cambodia Socio Economic Survey of 2004 revealed that the total labor force was about 7.5 million in 2004 or 56 percent of the total population. And there are more than 0.2 million persons entering into the labor market every year. Based on this trend, EIC estimated that the total labor force would reach about 8.4 million in 2007, of which about 20 percent are under eighteen years old. With a “narrow definition” of employment, which is, a person is considered to have a job if he or she works at least one hour during the past reference survey week, the employment rate was more than 99 percent in 2004. Thus, it should be noted that, this rate included under-employment rate.

Table 5.1: Cambodia's Population and Labor Force (% of growth)

	2002	2003	2004	2005	2006	2007p
Population	1.67%	1.70%	1.68%	2.06%	2.42%	1.99%
Labor Force	3.37%	3.41%	3.44%	3.41%	3.26%	2.91%
Employment	0.29%	2.61%	3.19%	3.72%	3.73%	2.93%
<i>Formal Sectors</i>	1.05%	0.16%	6.93%	5.65%	6.91%	5.95%
Textile	6.13%	5.37%	14.13%	9.94%	14.00%	11.06%
Tourism	7.69%	-2.86%	14.04%	13.37%	7.92%	7.41%
Others	-2.88%	-2.53%	0.87%	0.86%	0.85%	0.85%
<i>Informal Sectors</i>	0.18%	2.99%	2.63%	3.43%	3.23%	2.44%
Agricultural Sector	-1.09%	2.38%	2.24%	2.22%	2.07%	1.70%
Others	6.25%	5.69%	4.32%	8.52%	7.82%	5.21%

Sources: *EIC model projections*

Based on the good performance of the garment industry and tourism, jobs created in these two sectors continue their growth at a significant rate in 2007. For the garment industry, Garment workers employed in the GMAC factories members reached about 350,000 percent in September 2007, about 7.6 percent higher than that of September 2006. In total, garment workers are expected to increase

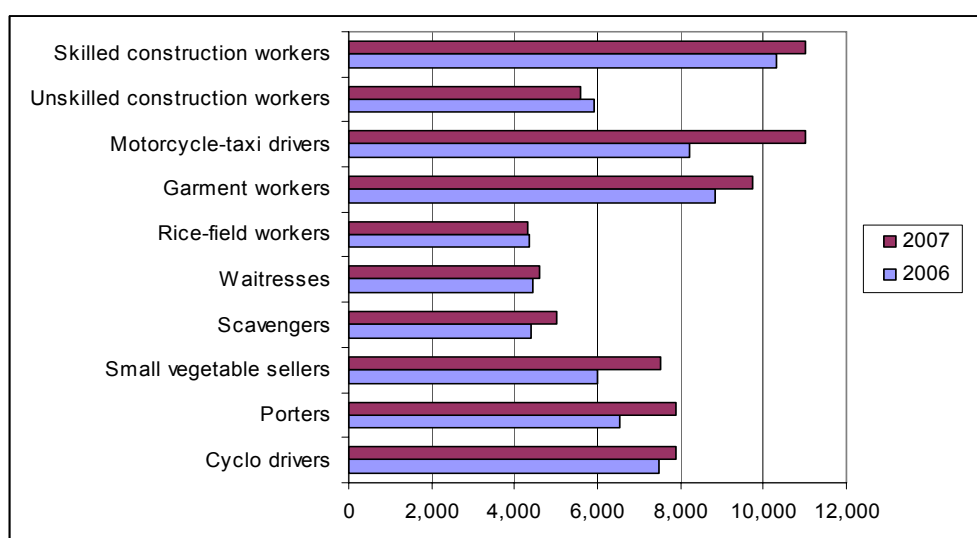
about 11.06 percent in 2007, about 3 percent slower than that in 2006 due to a slower growth rate of garment product exports. At the same time, employment in the tourism sector is expected to increase about 7.41 percent in 2007, relatively the same as that of 2006.

Nonetheless, given a slower growth rate in the agricultural sector, new jobs created in the agriculture remain low and are expected to be about only 1.7 percent in 2007, down from 2.07 percent in 2006. Thus, the under-employment rate is still high. Most of the workers continue to migrate to Phnom Penh and other urban areas in other sectors which require lower skill, such as the garment factory, construction and tourism, as well as some other service sectors at the country borders. In sum, total employment is expected to grow about 5.9 percent in 2007, 1 percent lower than that of 2006.

5.2. Incomes

There are no updated data 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 5.2: Real Terms of Daily Average Earnings of Vulnerable Workers
(November 2000 prices, Cambodian Riel)**



Source: Data compiled from CDRI

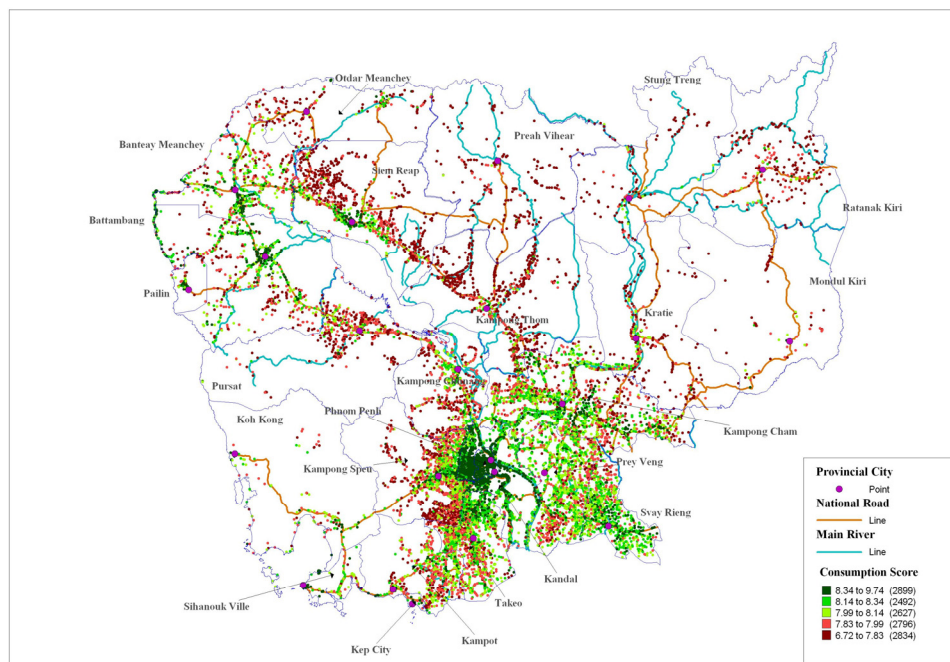
Figure 5.2 depicts the daily earnings of vulnerable workers between 2006 and 2007. In real terms, the daily earnings of all vulnerable workers increased, except those of unskilled construction workers, garment workers whose daily earnings decreased slightly. Daily earnings of motorcycle-taxi drivers increased significantly, about 34 percent in average in 2007 compared to those of 2006; followed by those of small vegetable sellers and porters, whose daily earnings increased by about 25 percent and 20 percent in 2007 compared to those of 2006 respectively.

5.3. Poverty

Based on national poverty line, poverty rate in Cambodia has dropped from about 47 percent in 1994 to about 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 has been reduced by about 1 per cent, which is 30,000 persons per annum. This reduction pace is perceived slower than 1.3 percent in Lao PDR or 3.2 percent in Vietnam, given their higher economic growth rate. At the same time, Gini coefficient increased from 0.347 in 1993 to 0.403 in 2004. This means that inequality in Cambodia has been high and rising.

The slower reduction pace and higher inequality in Cambodia was well reflected in the pattern of the current economic growth. The growth has been mainly generated from the garment and tourism industries. Thus, the growth concentrated mainly in the capital, Phnom Penh and its peripherals, and the tourist town, Siem Reap-Angkor. The growth of rural-based and agricultural sector, which is the main income source for the poorer and poorest, has been seen as very slow. This pattern of growth may lead to a slower rate of poverty reduction and increase of inequality.

Figure 5.3: Village Consumption Score in 2006



Source: Andrew, compiled from commune database of SEILA program

Note: The higher the consumption score or the richer is the stronger green dots, whereas the less the consumption score or the poorer is the stronger red dots.

EIC made qualitative survey with village leaders of some villages surrounding Phnom Penh, who get benefit from the growth, and some villages surrounding Siemreap centre, which remain poor. Qualitative interview with village chiefs surrounding Phnom Penh revealed that their villagers seem to benefit from the fast economic growth during the last decade. The Private sector seems to play a very important role in improving villagers' living standard. In general, the living standards of our people are beffer off since their main income sources were changed from crop cultivation to job created by the garment industry, construction, and land price increase.

Beside, qualitative interview with village chiefs surrounding Siemreap centre revealed that the living standards of their people seem to be slightly increased or remain stable. They mostly rely on crop production, mostly paddy production, which greatly fluctuates with the unpredictable weather conditions. The benefit from the fast economic growth as the second job at the centre such as construction seems to be messed up by primary jobs such as crop cultivation. One drought or inundation is enough to put these villages back to poverty. Thus, their state of poverty or wealth is almost unchanged during that period.

Part II

STRUCTURAL REFORMS: CURRENT IMPLEMENTATION AND PROSPECTS

Chapter 6

Banking and Financial Sector Reform

A soundly developed banking and financial system is a key foundation to support Cambodia's private sector and economic growth. To promote the country's financial sector development, the Royal Government of Cambodia (RGC) adopted the Financial Sector Blueprint 2001-2010 in August 2001. In 2006 the Blueprint was revised and updated in the Financial Sector Development Strategy 2006-2015 (FSDS 2006-2015). It was adopted in February 2007 and officially launched in June 2007.

6.1. Banking

In the new Blueprint 2006-2015, the schedule to complete goals in the banking sector was revised to take into account delays in implementing the Blueprint 2001-2010. Immediate priorities to be achieved by 2009 include among others the automation of cheque clearing and settlement, the development of a national wholesale electronic payment system, and the development of information technology and management information systems at the National Bank of Cambodia (NBC).

Table 6.1 New Blueprint's Immediate Priorities (Target: 2006-2009)

Banking	Rural Finance
<ul style="list-style-type: none">• Capacity building of NBC and banks; consumer education and awareness activities• Automating cheque clearing and settlement• Developing national wholesale electronic payment system with banks and specialized banks• Bringing money lenders and changers into the formal regulatory framework• Comprehensive development of NBC IT and MIS systems• Strengthening NBC and judicial implementation / enforcement	<ul style="list-style-type: none">• Developing framework for microfinance:<ul style="list-style-type: none">✓ MFIs and CMA – operations✓ NBC – regulation and supervision✓ MEF – policy development• Improving MFI common reporting standards• Developing improved NBC methodologies for assessing and rating MFIs• Review of existing framework for unregistered/informal financial institutions• Improving MIS in MFIs• Conducting short studies to prepare groundwork for development program• Creating capabilities to support other forms of MFIs (community-based, non-registered, etc.)

Source: *Financial Sector Development Strategy 2006-2015*

In the first semester 2007, the NBC continues to monitor banks' activities through both off-site surveillance and on-site inspections. In its interim annual report for 2007, the central bank

noted that the results of monitoring were positive. The majority of banks were profitable and they globally respected the law and the warnings issued by the NBC¹⁵.

Full on-site inspections were conducted in five commercial banks, including one foreign branch and one specialized bank. According to the NBC planning, 15 banks should be inspected in 2007.

In order to further improve its monitoring capability, the NBC introduced COBRA (Cambodian Offsite Bank Reporting for prompt corrective Action), a new computer software to analyze banks' documents. After a trial period, the COBRA program proved to be more effective than hand-work, in terms of rapidity, analysis and accuracy.

In August 2007 the NBC also issued two Prakas related to risk management to the banks. The Prakas on the Monitoring of Banks' and Financial Institutions' Net Open Position in foreign currency instructed all banks and financial institutions to establish an internal control system of their foreign exchange risks, stating that the ratio of their net open positions in foreign currencies to their net worth must not exceed 20 percent.

The Prakas on Amendment of the Prakas Relating to Banks' Solvency Ratio mainly revised the method to calculate the ratio.

The Credit Information Sharing (CIS) system, organized by two Prakas issued in early 2006, allows bank members to share their clients' credit information. Since the launching of its website in September last year, the CIS system is encountering some technical difficulties due to the small size of its server. In addition, the system is currently being re-installed¹⁶.

The CIS database system is expected to expand smoothly with the full cooperation of the banks which present consent forms to their clients, although some of these are expected to refuse to sign. According to estimates by one NBC official, the CIS database is between 20 percent and 30 percent of completion.

Interest rates on loans in US\$ and Cambodian Riels (CR) increased in the first semester 2007 compared to late 2006. For loans in

¹⁵ NBC (2007), "First Semester Report 2007"

¹⁶ Interview with NBC officials

US\$, interest rates vary from 16.5 percent to 17.2 percent depending on the length of loans, while the rates ranged between 16.2 percent and 16.8 percent in September 2006. The minimum rate for loans in CR is 22.9 percent, 4.7 percent point higher than in 2006.

Interest rates on deposits in US\$ and CR remained stable in June 2007 compared to 2006 last quarter. For deposits in US\$, the maximum interest rate slightly increased by 0.4 percent point. However deposits in CR had their maximum rate decreased by 0.3 percent point¹⁷.

Table 6.2 Interest Rates as of June 2007

Type of operation	Average		
	US\$	Cambodian Riels	Other Currency
Loan	16.5% - 17.2%	22.9% - 23.1%	18% - 22.1%
Deposit	2.8% - 4.8% (Fixed)	4.2% - 6.4% (Fixed)	4% - 5.2% (Fixed)
	1% (Saving)	1.8% (Saving)	3% (Saving)

Source: National Bank of Cambodia, “Quarter Bulletin No 21”, Quarter 3, 2007.

As for the liquidation of the First Overseas Bank, the NBC reported the collection of debts and the confiscation of the bank’s real estate. The central bank is confident to be able to refund all customers’ deposits in the insolvent bank.

Regarding the Blueprint’s part on the Foundations of Financial Sector Development, it is worthy to note that the Law on Anti-Money Laundering and Combating Terrorist Financing was promulgated in June 2007. The law tightens bank reporting procedures and increases staff accountability.

Also the Draft Financial Leasing Law was sent to the Council of Ministers since early 2007 and awaits the Inter-ministerial meeting before further proceedings.

6.2. Microfinance

The FSDS 2006-2015 considers “microfinance” sector instead of “rural finance” as defined by the Blueprint 2001-2010, in order to encompass financial services demand from the poor in urban areas as well.

¹⁷ NBC (2006), “Quarter Bulletin, No 18”, Quarter 4, 2006; NBC (2007), “Quarter Bulletin, No 21”, Quarter 3, 2007

In the first semester 2007, microfinance entities reported an increase in both credit volume and customers. Micro Finance Institutions (MFI) and Rural Credit Operators provided a total of CR 479 billion in credit and the number of borrowers reached about 548,000 people, a 16-percent increase in comparison with December 2006.

Amount in both mandatory and voluntary deposits in MFIs increased 47 percent to CR 17.5 billion. In the first six months of this year, depositors reached more than 205,500 people, that is a 81 percent increase compared to the figure registered in December 2006.

Licensed MFIs increased by one, totaling 17 as of June 2007. In addition Credit Operations are provided by about 85 NGOs, among which 25 are registered. At the same time, applications to be registered as Rural Credit Operators were submitted to the NBC by eight associations.

In the first six months of this year, onsite inspections were conducted in three MFIs only. The monitoring revealed several challenges that MFIs and micro-credit associations are facing: lack of funding sources, lack of skilled human resources, and lack of cooperation between MFIs and land authorities.

Some progress has been made though in developing the regulatory framework of microfinance. The NBC issued two Prakas in August 2007 respectively on Microfinance Institutions' Net Worth and on Microfinance Institutions' Solvency Ratio. MFIs have to maintain a solvency ratio of no less than 15 percent. Those Prakas streamlined the requirements in microfinance. In addition, a National Forum on Creating Conducive Rural Finance Policy Environment and Regulatory Framework was held in July 2007 in Kampong Cham. The forum aimed at taking stock of the performance made in microfinance and at undertaking a plan of action for the sector development.

In order to further improve risks management in microfinance, the NBC plans to expand credit information sharing to microfinance sector. Licensed MFIs will be able to share information about their clients' credit status once the CIS database system is stable and runs better.

Overall, less has been done in the microfinance sector than in the banking sector. The number of onsite inspections dropped and regulations protecting MFIs' and Credit Operators' deposits clients are still to be drafted and adopted.

Table 6.3 Recent Developments in the Banking and Microfinance sector, 2007

Progress	What is next?
<ul style="list-style-type: none"> • May 24, 2007: Promulgation of Law on Secured Transaction • June 7, 2007: Financial Sector Development Strategy 2006-2015 officially launched • June 24, 2007: Promulgation of the Law on Anti-Money Laundering and Combating Terrorist Financing • August 27, 2007: <ul style="list-style-type: none"> ✓ Prakas on the Calculation of Microfinance Institutions' Net Worth ✓ Prakas on Microfinance Institutions' Solvency Ratio ✓ Prakas on the Monitoring of Banks' and Financial Institutions' Net Open Positions in foreign currency ✓ Prakas on Amendment of Prakas Relating to Banks' Solvency Ratio • October 2007: CIS Database System at 20-30% of completion • First Semester 2007: Trial introduction of COBRA program in offsite bank monitoring • September 12, 2007: Law on the Issuance and Trading Non Government Securities was adopted by National Assembly • October 16, 2007: Law on Bankruptcy was passed by National Assembly 	<ul style="list-style-type: none"> • Enactment of Law on: <ul style="list-style-type: none"> ✓ Financial Leasing ✓ Insolvency • Including MFIs as members of the CIS system • Full implementation of COBRA program • Drafting sub-decree, Prakas and circulars to implement the Law on Anti-Money Laundering and Combating Terrorist Financing

Source: *Compiled from government's reports and interviews, October 2007*

Chapter 7

Public Financial Reform

To strengthen revenue mobilization and to improve public expenditure management and accountability, the Royal Government of Cambodia launched the Public Financial Management Reform Program (PFMRP) in 2004 with support from various donors, mainly channeled through a Multi-Donor Trust Fund (MDTF) and administered by the World Bank.

The PFMRP is a 10-year reform program which employs a sequenced platform approach that utilizes a series of reform measures designed to address the weakness of the Cambodia's Public Financial Management System.

- Platform 1: Making the Budget more credible in terms of timely and predictable delivery of funds (including improving the comprehensiveness of the budget; strengthening macro-fiscal and revenues forecasting and streamlining spending processes);
- Platform 2: Implementing effective financial accountability;
- Platform 3: Achieving a fully affordable policy agenda through policy-budget linkage; and
- Platform 4: Achieving effective program performance accountability.

Currently, the PFMRP is at the stage of completing Platform 1 and beginning the implementation of Platform 2.

Platform 1 has been in progress since early 2005. It was planned for completion in 15 to 18 months. Overall, Platform 1 has not been fully completed yet. However, significant progress has been made in the area towards the expected output of the platform. For the first semester of 2007, the results of the PFMRP include:

Budget Reforms

Continuing from the previous semester, the new budget process is still dominating the public financial reform work. This semester

marks the first time implementation of the new budget process which is guided by the 2007 Budget Law.

- A new budget cycle and calendar which was introduced in the Law has been put into practice providing more time for preparation of the macro economic framework and discussion between MEF, Line Ministries and other stakeholders.
- Budget Strategic Plan (BSP) which was also introduced for 2007 has been in use for the preparation of the 2008 Budget. The BSP requires the inclusion of a capital budget encompassing national and development partner financed capital expenditures including ongoing projects.
- Pilot-test of Program Budgeting: Program Budget is a kind of budget arrangement based on programs with prior decision on expected results to be evaluated through annual outputs, outcomes and indicators according to each program, sub-program and activity/action. For the year 2007, the pilot of this implementation of program budgeting is based on the implemented Priority Action Programs (PAP) starting with the seven priority ministries¹⁸. In the budget law, the fund for program budgeting for 2007 is planned at CR 396,225 million or around 14 percent of the total current budget¹⁹. This introduction of program budgeting is seen as an essential step for building budget policy linkages and improving budget preparation processes.
- Budget execution procedure has been streamlined by the fact that the MEF circular and an inter-ministerial circular and manual were issued and took effect as of January 1, 2007²⁰. With this new provision, for non-procurement items, the commitments and payment authorization process have been combined. For procurement items, commitment authority is extended for six months based on the procurement plan. It also

¹⁸ Priority ministries include: Ministry of Education, Youth and Sports, Ministry of Health, Ministry of Agriculture, Forestry and Fisheries, Ministry of Rural Development, Ministry of Land Management and Urbanization, Ministry of Justice, and Ministry of Women Affairs.

¹⁹ Law on Budget, 2007.

²⁰ Council of Development of Cambodia (CDC), *Report on Progress towards targets of 2006 Joint Monitoring Indicators*, 2007. p.15

allows the financial controllers in line ministries to authorize salary payment. For the seven priority ministries implementing the pilot program budgeting, the circular introduces a cash advance system which allows the implementers to advance up to 30 percent of the total budget for non-procurement items and up to 25 percent for procurement items. According to the JMI progress report, the processing time for commitment and payment approval for non-procurement items has been reduced by 85 percent from 23 days to just only 3 days.

Debt Management

Strengthening debt management has been one of the actions identified in the PFMRP. A draft of Debt Management Manual was completed in 2006. Considerable progress is also seen in the plan to up-grade both hardware and software for debt management, monitoring and recording. According to PFMRP's 2007 External Advisory Panel report, a contract was signed with the supplier in February 2007 and the new software will be installed later this year.

Expansion of the Use of Banking System

Following a pilot-test direct payment of senior officers' salaries into bank account in MEF and MOH, the initiative has been expanded to other levels and provinces. Currently the direct payment through bank account is being implemented for all government officials with a salary at 400,000 CR and higher at central level, and for government officials with a salary at 200,000 CR or higher at provincial level in Phnom Penh, Siem Reap and Sihanoukville.

Introduction of Internal Auditing

In its effort to strengthen and improve the efficiency of the expenditure, the government required each ministry to establish an internal audit department to perform audit function within the ministry. Currently, an Internal Audit Department has been established in 22 line ministries. However, it is not sure how many of the 22 are in operational. According to the CDC's 2007 report, by the end of last year only 6 of the 19 (established by the time) were operational in term of staffing and training.

Fiscal Decentralization

Fiscal Decentralization is part of the RCG's Decentralization and Deconcentration (D&D) program. In this area considerable progress has been seen with the draft of Prakas on Establishment of Local Finance Office in every Provincial Department of Economy and Finance.

Currently, decentralization is implemented at the commune level supported by a wide range of laws and regulations, such as the Law on the Administration and Management of Communes and the Law on Election of Commune Councils. In addition to political empowerment, the commune council is also provided with decision making authority on service delivery and some fiscal matters. The commune is legally entitled to three main sources of revenues: *own-source revenues, funds transferred from the central government and local contributions from people.*

Under the law, communes have the right to collect revenues from taxes and fees and may be entitled to some tax sharing with the central government. However, until today, the communes have yet to carry out their own revenue collection, since the implementing regulation to make this function operational is not in place. Without practical policies, the communes are still unlikely to generate much revenue as they can be bullied by their superiors, the district and provincial authorities.

The communes' capacity to carry out these fiscal duties is also a concern. With limited human resources capacity and economic potential in their community, only a small percentage of the communes are confident that they can stand on their own, without support from the central government. A clear fiscal framework, technical assistance and capacity building for commune staff are crucial for the system to be operational.

Establishment of Financial Management Information System (FMIS)

FMIS is a system required in the PFM RP to achieve the outcome of Platform 2 and the later stage. With the World Bank's expectation to provide support of around \$US8.4 million, it is the

largest component of the PFMRP in monetary term²¹. The process of acquisition of this system has been in progress. The new FMIS Unit has been established attached to the Economic and Public Finance Policy Department of the MEF. The FMIS will initially contain general ledger, budget preparation, procurement, and accounts payable and receivable modules.

The initial FMIS design and specification have been completed. The first stage of bidding process has been completed and currently, the draft of a second stage bidding document has been drafted and circulated for comments.

According to the MEF, the pilot stage of FMIS is expected to be commenced in June 2008. The pilot stage will include MEF departments, MOEYS, MoH and five provincial treasuries.

Public Procurement

Public Procurement is considered to be the main source of the government expenditure. In the PFMRP, the procurement procedure figures as one of the policies that need to be reformed and strengthened for public expenditure to be transparent. Reform in this area has been accelerated by the MEF. The Sub-decree on Public Procurement was adopted on October 18, 2006. This new sub-decree is to ensure the regularity of the public expenditure in the procurement field. It sets out the broad principles and parameters for public procurement system and it guarantees 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. On January 23, 2007, the Procurement Manual was issued to complement the implementation of the new sub-decree. Other relevant regulations that have been issued include²²:

- Prakas 045 to develop procurement authority to line ministries and SOEs by raising the thresholds under which ministries may procure it by themselves;
- Prakas 401 to limit the use of direct contracting by ministries;

²¹ MEF, PFMRP, 2007 External Advisory Panel Report, 20 April 2007. p. 44

²² MEF, Public Financial Management Reform Program, *2007 External Advisory Panel Report*, 2007. p. 41

- Circular 102 requiring ministries to prepare annual procurement plans which are approved by MEF; and
- Prakas 101 to distribute the procurement manual.

In addition to the above mentioned, the new *Internal Rules and Regulations (IRRs)* was adopted in January 2007 to support the implementation of the above sub-decree (IRR). With the aim to increase economy, efficiency and transparency public procurement, these new IRRs provides detailed procurement procedures and a greater clarity of roles and responsibilities in the management of procurement function. Currently, with technical assistance from the Multi-Donor Trust Fund, the Public Procurement Department (PPD) of MEF is in the process of preparing a draft Procurement Law. According to the PPD's prediction, the Procurement Law will not be completed until 2009.

Overall, PFMRP has made substantial progress towards achieving the objective of the Platform 1 that is to have a more Credible Budget. Among others, the new calendar for budget preparation, the new accounting chart, the pilot-test of program budgeting, the establishment of international audit departments and the expansion of the banking system would increase the credibility of the state budget.

However, putting all those new initiatives into practice still remains a challenge; for example, the report on the implementation of the first semester of 2007 has been delayed and it is not certain to what extent those new initiatives such as program budgeting can be implemented effectively. In addition, more work needs to be done to complete platform 1. And to ensure the effective enforcement of the reform, the government needs to pay more attention to the capacity building of the implementing government agencies to carry out the new approaches, laws, regulations and procedures.

Chapter 8

Trade Reform

Cambodia's trade reform has been characterized mainly by the accession process to the World Trade Organization. With a government commitment and effort since mid of the 1990s, Cambodia was approved to be a WTO member in 2003 and became a full-fledged WTO member in 2004 after the National Assembly ratified its membership.

In the WTO accession, Cambodia has committed to pass 46 essential laws in compliance with WTO requirement by 2006. However, this commitment was not fully accomplished by the agreed time frame. In addition to full-filling its commitment to the WTO, the government has been taking various measures to strengthen trade facilitation and economic integration in order to grab the benefit from the WTO membership and trade liberalization.

This section will look at the progress made during the first half of 2007 regarding the WTO commitments and the government's effort in improving trade regime and investment climate.

8.1. WTO Commitments

As mentioned earlier, 46 commitments have been identified as essential and need to be passed conformingly to the WTO commitment. 25 laws and regulations have been promulgated so far.

During the first half of 2007, six additional laws were adopted and promulgated. Those six laws are: Criminal Procedure Code, Law on Water Resources Management, Law on Customs, Law on Secured Transaction, Law on Land Traffic (Highway Code), and Law on Government Security.

Criminal Procedure Code, promulgated on August 10, 2007, is a new achievement of Cambodian legal framework after the promulgation of Civil Procedure Code. This modern procedure code is a crucial foundation of responding to some missing points in the current relevant penal regulations, and creating a new mechanism which provides comprehensive and clear understanding.

With the introduction of key underpinning laws pertaining to commercial activities, *Law on Secured Transaction* was promulgated on May 24, 2007 with the purpose of promoting economic activity through a unified set of rules on securing obligations with collaterals.

Law on Customs was promulgated on July 20, 2007. This law is aimed at providing the assessment and collection of duty taxes and fees on imported and exported goods, the control and regulation of the movement, storage and transit of such goods, promoting the prevention and suppression of fraud and smuggling, and participating in implementing the international trade policy of the Royal Government of Cambodia.

Law on Government Security was promulgated January 10, 2007. This law is to provide a framework of effectively issuing and managing state securities. In addition, this law contributes to the development of capital market in Cambodia. According to the law, the state securities may be printed in either local or foreign currency.

In order to enhance in-land trade within Cambodia, the *Law on Land Traffic* was promulgated on February 08, 2007. This law is aimed at maintaining order and safety in road trafficking, protecting human and animal lives and environment, curbing the effect on human health and the damage of the state and private properties, and curbing the offenses stemmed from the use of the roads.

Law on Water Resource Management is aimed at advancing Cambodia's water resource management. It aims at ensuring that water resource in Cambodia will be used effectively and in a sustainable manner in order to achieve social economic development and people's welfare.

Table 8.1: Necessary Laws needed to meet WTO requirements promulgated in 2007

1. Criminal Procedure Code	Adopted June 07, 2007 and promulgated on August 10, 2007
2. Law on Water Resources Management	Adopted on May 22, 2007 and promulgated on June 29, 2007
3. Law on Custom	Adopted on June 22, 2007 and promulgated on July 20, 2007
4. Law on Secured Transaction	Adopted on April 06, 2007 and promulgated on May 24, 2007
5. Law on Land Traffic (Highway Code)	Adopted on December 20, 2006 and promulgated on February 08, 2007
6. Law on Government Security	Adopted on November 30, 2006 and promulgated on January 10, 2007

Source: *Official Gazette and Interviews, October 2007.*

In comparison with the committed schedule for passing the laws, the progress towards meeting the WTO commitment has been very slow. Timeframes for the passing of several laws has been delayed. According to the interview with government officials, the delay has been partly due to the shortage of financial and technical resources and capacity. Lack of coordination among government ministries and agencies; the insufficient parliamentary session was also raised as an obstacle and a cause of the delay.

The remaining laws committed are still in draft at the responsible ministries (mostly at the Ministry of Commerce) and some are waiting for approval at the National Assembly. There are also few laws which are still at the preparation stage. Table 8.2 below shows the remaining laws committed to the WTO and its current status.

Table 8.2: Progress of Remaining Law for WTO

1. Law on Establishing the Commercial Court	Draft law at MoC. August 18, 2007, MoC's officers visited Thailand Commercial Court in order to learn some structure.
2. Civil Code	Draft law at NA, awaiting approval at the end of September 2007.
3. Criminal Code	Draft law at MoJ, being adjusted the last section and send to CoM.
4. Law on Geographical Indications	Draft law at Intellectual Property Department, MoC.
5. Laws on Layout Design of Integrated Circuit	Draft law at Industrial Property Department, MIME. It will be send to the World Intellectual Property Organization (WIPO)
6. Law on Plant Breeder Rights	Draft law at Industrial Property Department, MIME. It will be discussed in Inter-ministerial meeting of CoM, and might be changed to Law on Variety Protection or Law on Seed.
7. Law on Protection of Undisclosed Information	Draft law at MoC, awaiting comment from relevant ministries.
8. Law on Anti-dumping Measures and on Countervailing Measures	Draft law at CoM, awaiting approval
9. Law on Insolvency	Draft law at CoM, awaiting approval. It was discussed in CoM's meeting on August 17, 2007, and sent to NA.
10. Law on Financial Leasing	Draft law (NBC) was sent to CoM since early 2007. It has some problem related to Civil Code.
11. Law on Clean Water and Hygiene	Draft law at CoM, awaiting approval. It will be discussed in CoM's meeting.
12. Law on Telecommunication	Draft law at NA, awaiting approval

13. Law on Tourism Management in Cambodia	Draft law at MoT and was sent to IFC. August 24, 2007, it was discussed at workshop, after sent to CoM.
14. Law on Civil Aviation	Draft law at NA, awaiting approval. It was checked by Ninth Committee.
15. Maritime Code	Draft law at MTPW. It will be discussed in workshop on November 9, 2007 and send to MoC.
16. Law on Commercial Contract	Draft law at MoC. It might be send to NA by 2008.
17. Law on Commercial Agency	Draft law at CoM, awaiting for comment.
18. Law on Competition	Draft law at MoC.
19. Law on Safeguard Measures	Preparation stage at MoC, awaiting for Technical Assistant. Nothing has been done until now.
20. Royal Decree on Cooperatives	Unidentifiable
21 Law on Rules of Origin	Unidentifiable

Source: *Base on consultation with various government ministries and agencies.*

8.2. Trade Facilitation and Private Sector Development

In addition to the above effort on the legislative commitment to the WTO, the government has also put considerable effort in trade facilitation and private sector development.

Considerable progress with regard to trade facilitation and private sector development has been reported. Following the Sub-decree on trade facilitation through a risk management approaches to inspection and clearance of imports and exports of goods which was adopted in March 2006, the Risk Management Unit was established in Customs and Excise Department²³. The Single Administrative Document was approved by the steering committee and will be piloted in later this year.

However, the Single Window Project which is seen as a pillar for trade facilitation has been stalled. According to the 2007 Joint Monitoring Indicator (JMI) report, the government decided to delay the implementation of this project and it may resume in 2012 following the ASEAN Single Window Calendar.

²³ Cambodia's Development Partners' Statement at the CDCF, June 19, 2007

A \$US2.2 million ASYCUDA (Automated SYstem for CUstoms DAta) which was launched last year has been reported to have steady progress in its implementation. In terms of trade, this system will provide reliable data on trade statistics. In addition, it will better facilitate the import and export process by providing a faster-cost saving, predictable and transparent treatment in custom clearance process.

As mentioned earlier, the progress in the legislative commitment has been very slow, the government needs to take a more serious measure to identify and tackle the problem and challenge it in order to speed up the progress in this field. However, in the area of trade facilitation and private sector development, the government has made some remarkable progress. The noticeable progress includes the improved institutional mechanism of Single Administrative Document which has resulted in reducing time required for investment approval, import and export processing, setting transparent tariff for public service provision as well streamlining the inter-ministerial procedures for goods inspection. The improvement in rolling out the risk management and custom automation system as well as the preparation of legal framework institutional mechanism for SEZs management and development are also achievements that should not be overlooked.

Chapter 9

Administrative Reform

The Administrative Reform is the key strategy of the government to promote governance which is at the core of the government reform agenda. With the successful administrative reforms, the public sector performance and service delivery will be improved, thus promoting social welfare, improving competitiveness, growth and poverty reduction. The RCG has been undertaking two different approaches in its administrative reform agenda. At the central level, the reform focuses on improving civil servant remuneration, human resources capacity and human resources management. At the sub-national level, the reform focuses on decentralization and deconcentration to promote democracy and good governance.

9.1. Central Administration Reform

Considerable improvement has been made in this area. The most noticeable improvement has been seen in civil servant remuneration. According to the Council of Administrative Reform (CAR), the average salary of the civil servant was increased by 163% from US\$ 19.5/month in January 2002 to US\$51.3/month in July 2007. In addition, the Prime Minister recently announced that the base salary of civil servants will be increased by 25% starting from July 2007 and from 2008 on, the salary of civil servants, police and military personnel will be increased by 20% a year²⁴. In addition to the base salary increase, the government has also developed an allowance system that complements the base salary.

Slow progress has also been made in the implementation of Merit Based Pay Initiatives (MBPIs). The MBPIs commenced in late 2005 to introduce into the civil service higher pay coupled with meritocratic selection and performance management on a sustainable basis. It was first launched as a pilot project in MEF to be established in all line ministries. Currently, there are serious discussions on developing and

²⁴ Announcement of the Council of Administrative Reform. *“Civil servants base salary will be increased by 25%.* Retrieved from http://www.car.gov.kh/announcement/basic_salary_increase_kh.asp on 15/10/2007

implementing MBPIs in MoH, MoC, MoI, MoEYS, and MLMUPC. However, MBPIs is yet to be established in other ministries.

Beside MBPIs and other initiatives, CAR has also developed the Priority Mission Group (PMG) model and requested financial support from development partners. However, development partners require the PMG to be improved before they decide to support it financially.

Strong effort was also put to improve the management of human resources management. During the first Cambodia Development Cooperation Forum (CDCF) in June this year, the deputy prime minister, H.E. Sok An mentioned that the size and composition of the Civil Service is managed and controlled with the strengthening of Human Resources Management Processes and Human Resources Management Information System. The concept paper on Human Resources Management (HRM) and Human Resource Development (HRD) which will strengthen merit based practices and introduce performance enhancement mechanism were developed and circulated in the PAR TWG since October last year. However, there is no noticeable development since then.

Public Service Delivery Policy has already been developed and is being implemented. This policy accompanies the concept of “special operating agency” in which the One Window Service policy has been integrated. This is expected to provide strengthened civil servants’ performance and thus enhance service delivery. Other policies that were developed include Medium Term Remuneration Policy and An Employment Policy.

With the initiatives and policies mentioned above CAR is quite optimistic that it will lead to the improvement in attitudes, behavior and competencies of civil servants to become service providers and thus improve service delivery and competencies in all sectors. However, from the Civil Society Organizations (CSOs) and development partners’ point of view, the speed of the reform and the effort and resources that the government put into the central administrative reform is simply not sufficient, given the seriousness of the problem caused by the weakness of the current civil service.

During the 9th Government Donor Committee Coordination (GDCC) meeting in February this year, the development partners expressed many concerns and disappointments. The main concerns are the failure of the PAR TWG, the slow progress in the establishment of MBPIs in other line ministries following the pilot test in MEF, and the failure to improve the PMG model that the development partners view as weak in design.

Overall, there is an improvement in the central administrative reform, especially the increment of the civil servants base salary and the development of relevant policies to strengthen human resources management practice as well as to enhance service delivery. However, there is still a lot of rooms left to deepen and speed up the reform process.

Given the high rate of economic growth, the increase in the revenue collection and the potential new sources of revenues including the revenues from oil and mining; it is clear that there are more resources available for the speeding up the rise of civil service wages in a fiscal prudent way. Though there has been an increase on the average salary of the civil servants by 10 to 15 % annually in recent years, the current level of the average salary just reached US\$52 per month, which is still very low by any standard. With this level of salary, skilled staff cannot be recruited or retained and motivated to achieve adequate levels of productivity.

9.2. Sub-National Administrative Reform

Sub-national administrative reform in Cambodia is characterized by the implementation of Decentralization and Deconcentration program (D&D). It is an important tool for the government to promote and develop democratic governance at sub-national administration level. The D&D program is also seen as a tool to help improving service delivery to meet the need of the local communities. Under the program some levels of managerial decision-making and resource mobilization are provided to the local authority which is empowered by the direct and indirect election processes.

The D&D program has been implemented since 2002 when the first Commune election was held and it is considered to be one of the

most successful government reform programs. The second Commune election was held on April 01, 2007 with a remarkable improvement compared to the first one. It was marked by much less violence, threats, and confrontation. Currently, the perception of the vast majority on the popularity of the commune council has changed. They notice the commune councilors now respect ordinary people and deal with the problems that people present to them.²⁵ This clearly shows that public service delivery at the local level has been improved. However, there are still many challenges regarding the empowerment of the local authority which results mainly in a lack of legal framework for the operational administration and lack of capacity of the commune council.

The government has been making important efforts to address the above challenges. In August 2006, the National Committee for the Management of Decentralization and De-concentration Reform (NCDD) composed of selected line ministries and chaired by the Minister of Interior was established to allow more efficient engagement and participation of the relevant ministries and the institution of the sub-national reform agenda.

The first draft of the Organic Law which consists of five volumes was completed in December 2006 and the consultation and the discussion of various aspects of the draft law within NCDD were carried out as well in forums with the commune council, NGOs, development partner communities and line ministries. However, as of today, the draft law is yet to be ready to be submitted to the National Assembly.

The government is committed to the formulation and approval of the National Program on Sub-National Democratic Development by the end of this year. The program will be under the leadership of the NCDD Task Force. This program is expected to promote greater alignment of government, civil society and donor support, to enhance democracy and to reduce poverty in Cambodia.

²⁵ Development Partner's Consensus Statement on Governance for the CDCF June 19-20, 2007

Chapter 10

Legal and Judicial Reform

Since Cambodia achieved peace and national reconciliation, the Royal Government of Cambodia (RGC) has been pursuing various reform programs in order to speed up the country's development: legal and judicial reform included as a key mechanism of legal development frameworks to modernize legal structure and to develop Cambodia as a country with "Rule of Law". The economic integration into the region and the world, the accession into the World Trading System required Cambodia to establish various new laws in compliance with the world economic system, especially the WTO's. The deadlines for the completion of several legal frameworks were passed since the end of 2006. However, while there has been some improvement, more work remains to be completed.

10.1 Legal Reform

Several legal texts were made under the legal and judicial reform program, many of which are requirements of the WTO accession and commitment²⁶. During the last six months, three new regulations, two laws and one procedure code, were adopted by The National Assembly (NA) and promulgated by the King. They include Law on Secured Transaction promulgated on May 24, 2007, Law on Water Resources Management promulgated on June 29, 2007, and Criminal Procedure Code promulgated on August 10, 2007.

Nevertheless, many other laws and regulations are still yet to be finalized. According to the interview with government officials, the delay was due to the lack of human resource and technical capacity. The unclear and overlapping responsibility among the government institution in the preparation stage also contributes to the delay in law making. For instance, the delay in drafting Financial Leasing Law was due to the unclear responsibility between MoC and National Bank of Cambodia (NBC), while the preparation of Law on Safeguard Measures is delayed on account of lack of technical assistance.

²⁶ In the WTO accession, Cambodia has committed to create 46 new laws that need to be completed by the end of 2006.

Currently, some regulations were discussed at the responsible ministries, and some are waiting for comments from relevant institutes before debates in the Council of Ministers (CoM). While other draft laws and regulations are at the National Assembly (NA) awaiting approval. The draft laws and regulations that are already accelerated to the NA include Draft Law on Telecommunications, Draft Law on Civil Aviation, and Civil Code. Among the 46 laws and regulations that the government committed to establish by the end of 2006, only 25 were promulgated up to this day. However, more laws are expected to be passed in the second semester of 2007.

With the aspect of trade reform, interesting agreement has been reached by MoC and the Ministry of Justice (MoJ) on the establishment of a Commercial Tribunal at the first jurisdictional instance, thus creating a specialized chamber of commerce within the Appeals Court and Supreme Court²⁷. Ongoing of this platform, drafting legal texts on Establishing a Commercial Court was prepared; this draft is now under examination at MoC. Recently, some officers from MoC visited the Commercial Court in Thailand in order to learn and gain more experience in the field in order to speed up the drafting of the legal text.

10.2. Judicial Reform

To boost the development of market economy, enhancing trade and investment promotion, RGC has committed to reform the judicial system. In the reform framework, the primary step is to catch attention, to convince and to build confidence among citizens in a judiciary system. Structural reforming, strengthening legal institutes, drafting new laws and regulations were set up to facilitate the state to ensure that Cambodia is in the rule of law.

Royal School of Magistracy and Professional Training for Lawyers, were established with remarkable development in the area of human resources. However, the number of judges is still small and not sufficient to fulfill the court requirement according to the report of Council for Legal and Judicial Reform (CLJR)²⁸. In order to achieve

²⁷ EIC, Cambodia Economic Watch – October 2006, page 60

²⁸ Working Report for 2006 and Working Future Expect, June 06, 2007.

the effective implementation of the Laws, developing and utilizing the state's human resources is the key strategy. In addition, the selection process of the legal professional must be transparent.

Furthermore, the government put considerable effort in the development of eight fundamental legal texts, considered as the basis for judicial system and public administrative reforms. Those texts include six draft laws, and two main disseminated codes.

- Civil Procedure Code
- Criminal Procedure Code
- Draft Civil Code
- Draft Criminal Code
- Draft Law on the Organization and Functioning of the Courts
- Draft Law on the Statute of Judges and Prosecutors
- Draft Law on the Amendment of the Organization and Functioning of the Supreme Council of Magistracy
- Draft Law on Anti-Corruption

However, so far only the first two (Civil Procedure Code and Criminal Procedure Code) have been accomplished.

The new *Criminal Procedure Code* promulgated on August 10, 2007 provides a comprehensive, clear, an easy to understand legal framework which enables a smooth and effective implementation of the penal procedures in dealing with the present criminal cases. Moreover, the approval of this procedure code plays an important role in strengthening the rule of law and democracy, especially the modernization process of legal framework.

Civil Procedure Codes, promulgated on July 06, 2006, is the significant legal foundation which provides the court and other relevant institutions with a clear and complete legal framework as the procedural process for resolving cases for the people with justice.

The remaining six other basic laws are still in the development process. *Draft Civil Code* has been in the agenda of NA and is waiting

for discussion. The *Criminal Code*, *Law on the Organization and Functioning of the Courts*, *Law on the Statute of Judges and Prosecutors* and *Law on the Amendment of the Organization and Functioning of the Supreme Council of Magistracy* are still in the drafting stage at MoJ. For the Law on Anti-Corruption, the status is not clear, according to the report of the CLJR meeting on June 6, 2007, the Law on Anti-Corruption needs to be in line with the four codes and can only be completed after the completion of the four codes.

Table 10.1: Current Progress on the Eight Fundamental Legal Texts

1. Criminal Code	Draft law at MoJ, being adjusted the last section and send to CoM.
2. Criminal Procedure Code	Adopted on June 07, 2007 and promulgated on August 10, 2007
3. Civil Code	Draft law at NA since January 12, 2007, awaiting approval at the end of September 2007.
4. Civil Procedure Code	Adopted on May 26, 2006 and promulgated on July 06, 2006
5. Law on organization and functioning of the court	Finalized draft law, SMC commented and sent to MoJ for consideration.
6. Law on Amendment of the Organization and Functioning of the SCM	Draft was finalized by MoJ.
7. Law on the Status of Judges and Prosecutors	Draft law sent to the General Secretariat of the Government on October 1, 2007.
8. Law on Anti-Corruption	Waiting for the adoption of Criminal Code by the NA.

Source: *TWG on Legal and Judicial Reform and consultation with government official*

Credible and transparent legal framework together with independent judiciary will assist and speed up reform agendas of RGC. Concrete action should be appropriately taken in accordance with what have been scheduled, especially basic draft legal texts which are set as the current reform agenda. Without the passing of these necessary instruments, other reform agendas, particularly Legal and Judicial reform would certainly make slow progress and it will be difficult to meet the target timeline.

Chapter 11

Land and Natural Resource Reform

Land and natural resources such as fishery and forestry are the sources of the livelihood of the majority of Cambodian rural population. Improving access to land and natural resources is clearly one of the main pillars for the government reform program and development strategy that have direct impact on poverty reduction. However, according to the recent World Bank report, the landlessness has risen rapidly in recent years. In addition, vast areas of land have been granted under the Economic Land Concessions (ELCs) schemes which very often limit the access to natural resources of the rural poor. Quite often, ELCs were granted in a non-transparent manner and essential pre-conditions such as social and environmental impact assessments have not been met. The RCG is fully aware of all these challenges and has been taking tremendous reform effort to improve the situation. This section will look at the reform progress in the area of land, fisheries and forestry.

11.1. Land Reform

Access to land is the burning in Cambodia today. The RCG has repeatedly committed to combat illegal land encroachment. The Land Law was enforced since 2001; Strategy of Land Policy Framework and series of key sub-decree has been signed by the Prime Minister aiming at increasing transparency and accountability in land management and land use, which is mainly to tackle the problems in land conflict, indigenous people's right, economic and social land concession.

Land Dispute

Land dispute in Cambodia has its roots in the early 1990s when the country started to open to free market, privatization and the lack of legal instruments during that period. As a result, a small number of rich and powerful people illegally got the ownership over the lands which previously belonged to the poor farmers through various forms. The RCG has developed various mechanisms to solve the problem such as the 1999 Land Dispute Settlement Committees, a Cadastral Commission

System under the 2001 Land Law, and the National Authority for Land Dispute Resolution (NLDA).

Land tilling is also one of the mechanisms. It has been included in both NSDP and CMDG. The government set the target of land titling or registration at one million parcels by 2007 and by 65% of the total land parcels by 2015. Up to June 2007, the land registration effort has resulted in 1,226,536 land titles being issued, of which 107,569 titles were granted in the first semester of 2007²⁹.

During the first half of 2007, there were 251 land disputes cases filed through the Ministry of Land Management, Urbanization and Construction (MLMUC). Among 251 cases only 78 cases were solved and 141 cases were rejected or ignored³⁰. Another 116 cases were filled through the National Authority for Land Dispute Resolution³¹ making a total of 367 cases received by the two institutions. The number of complaints decreased compared to the same period last year where 493 complaints were received by MLMUC alone. The issuance of more than a million land titles contributes to this decrease.

Economic Land Concession

While the RCG views ELCs as one of the approaches for the development of the country, development partners and civil society see it as a mechanism that overshadowed the effort of the government and the progress being made in the management of agriculture and natural resources. The granting of ELCs can occur at both national and provincial levels. As mentioned earlier, very often ELCs have been granted in a non-transparent manner, and laws and regulations very often were not followed. These resulted in vast areas of land being kept by non-producers for speculation while poor farmers have no access to land.

The sub-decree on State Land Management and the sub-decree on Economic Land Concession are important milestones towards increased transparency and accountability in land management and land use. Based on the new sub-decrees ELC granting will be based on

²⁹ Ministry of Land Management, Urbanization and Construction, *Progress Report for First Semester 2007*.

³⁰ Ibid.

³¹ National Authority for Land Dispute Resolution, *2007 First Half-Year Report*.

the results of field surveys through inter-disciplinary mechanism and local consultations. In addition, the granted ELCs have been under close monitoring. This new approach has resulted in the confiscation of at least five ELCs, two ELCs were suspended for further inspection and several other ELCs were instructed to improve their activities. Negotiations to reduce the ELCs exceeding 10,000 hectares granted before the adoption of the 2001 Land Law are also taking place in order to achieve compliance with the Law and regulation. The reduction of five ELCs is expected this year. Cancellation or reduction in ELCs will make more land available for social land concession.

Social Land Concession

Demand for land has steadily increased due to population growth, increase of the newly married couples also growth, the increasing value of land and illegal land grabbing. To address the issues of landlessness of the poor people, the government adopted the Sub-decree on Social Land Concession in 2003. The social land concession program has been warmly welcomed by the development partners and civil society. However, slow progress has been made in this area. The result of the transferring of private state land to landless poor is remaining to be seen until today.

According to the MLMUC progress report, the ministry plans to distribute land to 10,000 families by 2010. However, this target is seemed far from being achieved. By the end of the first semester of 2007, work is still at the pilot stage in Kampong Cham and Kratie where total of 5,490 hectares of lands were classified as state's private land to be ready for use under the Social Land Concession Program. However, a lot more work still remains to be done before the land can actually be transferred to the landless poor.

More progress in this area where report by the National Authority (NLA) of a certain portion of land confiscated from illegal land grabbing is being used under the Social Land Concession program. According to the NLA two separate Sub-decrees have been prepared for the permanent reservation of government land and provision of social concession of land of at least 849 hectares (5 hectares in Takruok village, Treng commune, Rottanak Mondul district, Battambang province and 844 hectares in Trapeang Phleang

communes, Chhouk district and Stung Keo commune in Kampot province). Again, the actual transfer of the ownership of land to landless poor is yet to take place.

In addition, the MLMUC is also establishing an inter-ministerial working group together with MAFF to evaluate the cancelled ELCs in Kampong Thom province in order to divert those lands into use under the social land concession program.

Community Land

Community Land is another concern, especially for the indigenous community who often live in the area that is rich in natural resources and is under strong pressure for development in the area. Despite the protection of the indigenous communal land provided under the 2001 Land Law, the rates of land alienation are still high and according to an NGO Statement to the first CDCF in June, it is increasing. The progress in registration of indigenous communal land has been very slow. It has been six years since Land Law was enforced, various consultation workshops and forum have been held during late 2006 and early this year but the policy on registration of indigenous communal land was just submitted to the Council of Ministers on 17 May 2007 for review and adoption.³²

The inter-ministerial working group has been established for piloting the preparation of a Statute of Indigenous Community in three piloting villages (two in Ratanakiri and Mondulkiri). Though the statute of the three communities have been registered and formally recognized by the Ministry of Interior, the registration process is not yet developed beyond the pilot project. The unregistered communal lands remain at risk. The RCG decided to use the procedures and mechanism provided in the Sub-decree No. 118 on State Land Management as an interim measure to protect communal land before it is being registered.

Overall, progress has been made in the area of the management of state land; the 2001 Land Law, the Sub-Decree on State Land Management and Sub-Decree on Economic Land Concessions provide

³² Speech of H.E. Im Chhun Lim, Senior Minister, Minister of Land Management, Urban Planning and Construction at the First CDCF 19-20 June 2007.

a legal tool for transparent and accountable management of state land. The RCG keep working on various new legal texts such as sub-decrees, regulations, and policies. However, the challenges in the enforcement of those new legal provisions and the implementation of the new policies remain questionable. The RCG should put more focus on increasing the effectiveness of the enforcement and the implementation of the existing legislations that are already reasonably sound.

11.2. Forestry Reform

Forestry is the natural resource endowment that can be transformed into livelihood benefits. In Cambodia, higher poverty rates are observed for rural households mainly engaged in forestry activities. Therefore, securing access to forestry resources for the local users is crucial for the livelihood and the financial outcome of the rural poor.

The commercial forest concession has shown a failure in the past decade and the government has been under pressure to take a serious reform in the forestry sector. A considerable number of forest concessions were reduced making more forest areas available for the management under different schemes such as community forest.

The TWG F&E recently adopted a four-year Forestry and Environment Action Plan 2006-2010 in alignment with the NSDP. In addition, the Forestry Administration is making strong effort in the development of a National Forest Program which will lead to an improved planning, implementing and monitoring of forest related activities and will provide framework for prioritized action and investments. The progress in demarcation of the forest estate is moving at a slow speed. The RCG planned to demarcate 320,000 hectares and 600 km of forest estate boundary.

Despite the effort taken by the government, illegal logging is still taking place and forest land encroachment is still common in various parts of the country. The coverage cover declined in 2005-2006 to 59% percent which is slightly below the CMDG target of 60%. The government has been taking measures combating illegal grabbing of forest land through National and Sub-committees for Prevention, Control and Suppression of Forest Land Encroachment for Private Entitlement with collaboration from NLDA.

According to the report from the NLDA, during the first semester of 2007, strict administrative measures have been taken against government officials and traders who get involved in the violation of regulations and guidelines regarding land, forestry and fisheries management. For example, the Forest Administration has been requested by NLDA to take administrative measures against 15 officials who violated the law. In another case, action against two environmental officials and two traders in relation to illegal logging has been taken, though there is no detail of what kind of measures have been taken.

11.3. Fisheries Reform

Fisheries are very crucial for the development and the livelihood of Cambodian people. It supports the livelihood and food security of millions of Cambodians. The RCG has undertaken significant reforms in this sector since 2000. The reforms were to ensure a more poverty-oriented approach. Ensuring access rights of local communities is one the targets in the fisheries reform program. As a result, so far, 56.5% of commercial fishing lots were reduced for the benefit of small-scale or family fishing. In addition, 509 fishing communities have been established, of which 469 are fresh water fishing communities and 40 are marine fishing communities. The user rights of the communities on public fishing areas are broadly opened through Sub-Decree on Community Fisheries.

In the area of policy reforms, the Royal Decree on the establishment of community fisheries was signed in May 2005 and the Sub-Decree on community fisheries management was promulgated in June 2006. These legal texts provide a legal basis for the establishment of the community fisheries. The new Fisheries Law entered into force in May 2006. It indicates the roles and mandates of the new Fisheries Administration for sector development. The proclamation on the Functioning on the Fisheries Administration has been discussed and currently is waiting for approval from the MAFF. With the improved structure compared to in proceeding Department of Fisheries, the new structure is expected to become a more effective service provider in the sector especially at the commune council where there are substantial fisheries demands.

The formulation of a Cambodia Code of Conduct for Responsible Fisheries is another noticeable improvement. It is expected to provide framework for more benefit to the development of rural communities. Moreover, the Guidelines on Community Fisheries that set out a legal framework to ensure transparent, accountable and equitable implementation of the communities have been finalized and are expected to be implemented soon.

Therefore, there has been considerable progress in the policy reform; however, concern remains as the clarity over rights to use fisheries resources and the incentives to manage capture fisheries in sustainable manner are still lacking.

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 as well as 2008 and medium term. However, the growth is 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, Siemreap-Angkor. The rural-based and agricultural sectors are volatile and underdeveloped due to poor infrastructure.

This pattern of development has caused disparities between regions in terms of employment opportunities and income distributions. The prosperity created by growth has not been fairly distributed among the Cambodian people. Thus, the growth is unlikely to be concomitant with improvements in health, education and poverty reduction. 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.

Nonetheless, it is worthy nothing that Cambodia is in the transaction period, from donor-oriented economy to private-driven economy. It seems that the current economic performance and the upcoming Cambodia Stock Exchange Market and the exploitation of the Extractive Industry such as oil and gas in medium term are attracting the attention of many big investors to Cambodia. The trend of private sector growth is seen as increasing and the government will get more budgets to facilitate the growth in medium term. Boom in financial sector is also a good sign for boom in economic activities.

However, whether Cambodia could benefit from such opportunity or not, would depends largely on the government, especially the reform progress. Thus, the speed of Cambodia's economic growth in next coming years and pace of poverty reduction will principally depend on the Government reforms. These reforms, together with effective anti-corruption policies, could provide a preferred environment and opportunity for higher economic growth. However, these changes cannot be achieved in the short term.

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Appendix I

KEY ECONOMIC INDICATORS

Table A1.1: Main Economic Indicators

	1960	1990	2003	2004	2005	2006	2007	2008
Nominal GDP (million US\$)	577	1,404	4,656	5,315	6,278	7,265	8,269	9,286
Real GDP (% increase)	4.8%	4.5%	8.5%	10.0%	13.5%	10.8%	8.5%	8.0%
GDP per Capita (US\$)	83	136	349	392	454	513	572	633
GDP per Capita (% increase)	-	9.5%	7.1%	12.3%	15.7%	13.0%	11.6%	10.5%
Riel/Dollar Parity (year average)	35	537	3,975	4,016	4,092	4,103	4,100	4,100
Inflation in Riel (year average)	4.0%	141.0%	1.1%	3.9%	5.8%	4.7%	5.0%	4.0%
Inflation in Dollar (year average)	4.0%	0.4%	-0.3%	2.9%	3.8%	4.4%	5.1%	4.0%
Budget Revenue (% GDP)	19.7%	3.1%	9.5%	10.0%	10.2%	9.8%	10.3%	10.5%
Budget Expenditure (% GDP)	29.2%	15.9%	14.9%	13.9%	12.4%	13.8%	13.6%	14.4%
Current Public Deficit (% GDP)	-3.8%	-11.9%	0.8%	1.6%	2.0%	1.0%	1.4%	1.0%
Overall Public Deficit (% GDP)	-9.5%	-12.8%	-5.4%	-3.9%	-2.2%	-4.0%	-3.3%	-3.8%
Export of Goods (% GDP)	6.0%	3.4%	44.8%	48.7%	46.4%	50.8%	52.2%	51.7%
Import of Goods (% GDP)	18.4%	24.4%	57.3%	61.5%	62.6%	65.4%	66.8%	66.5%
Trade Balance (% GDP)	-12.4%	-21.0%	-12.5%	-12.8%	-16.2%	-14.5%	-14.7%	-14.8%
Current Account Balance (% GDP)	-13.4%	-22.7%	-10.6%	-8.2%	-9.4%	-7.2%	-7.1%	-5.9%
Net Foreign Reserves (million US\$)	57	0	633	709	834	1,100	1,208	1,321
Money - M1 (% GDP)	12.5%	5.3%	4.9%	5.2%	4.9%	5.4%	5.5%	5.7%
Money - M2 (% GDP)	23.6%	1.8%	13.0%	15.0%	14.4%	17.9%	24.5%	31.3%
Population (million)	6.9	10.3	13.3	13.6	13.8	14.2	14.4	14.7
Labor Force (% Population)	31.6%	47.0%	55.5%	56.4%	57.2%	57.6%	58.2%	58.8%

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	3,500	4,013
Current Revenue	4	23	1,733	2,107	2,474	2,882	3,490	4,003
Tax Revenue	3	13	1,220	1,577	1,911	2,271	2,810	3,197
Direct Taxes	1	1	150	158	222	331	440	500
Indirect Taxes	2	4	675	906	1,116	1,295	1,590	1,769
VAT	1	2	460	598	730	870	1,070	1,190
Excise duties	0	0	198	304	380	418	510	568
Others	1	2	17	4	6	7	10	11
Int'l Trade Taxes	1	9	395	513	573	645	780	929
Imports	1	9	375	491	551	617	750	896
Exports	0	0	18	19	19	24	25	25
Others	0	0	2	3	3	4	5	8
Non tax revenue	1	10	513	530	563	611	680	806
Fishery & Forestry	0	0	13	9	10	9	9	9
Civil Aviation	0	0	22	27	30	30	35	41
Royalties	0	0	5	8	2	2	4	4
PTT	0	0	120	94	123	83	75	101
Other non tax revenue	1	10	354	392	398	487	557	650
Capital Revenue	0	0	31	20	152	36	10	10
Expenditures	6	120	2,757	2,962	3,182	4,112	4,620	5,472
Capital Expenditures	1	7	1,171	1,193	1,215	1,520	1,600	1,860
Through Nat'l Treasury	1	7	333	296	315	379	380	493
Direct Foreign financed	0	0	838	896	900	1,141	1,220	1,366
Current Expenditures	5	113	1,586	1,769	1,967	2,592	3,020	3,612
Defense and Security	2	89	411	423	451	520	620	749
Salaries	1	9	287	296	306	327	380	459
Other	1	80	124	127	145	193	240	290
Civil Administration	3	25	1,175	1,346	1,516	2,072	2,400	2,864
Salaries	2	12	327	343	405	495	600	707
Other	1	13	848	1,003	1,111	1,577	1,800	2,157

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

	1960	1990	2003	2004	2005	2006	2007	2008
Current deficit	-1	-90	147	338	507	290	470	391
Overall deficit	-2	-97	-992	-835	-556	-1,194	-1,120	-1,459
Financing	2	97	992	835	556	1,194	1,120	1,459
Foreign financing	1	77	886	894	984	1,584	1,280	1,459
Grants	1	70	382	372	538	790	430	450
Loans (net)	0	7	504	522	446	794	850	1,009
Domestic financed	1	20	106	-59	-428	-390	-160	0
Banks	0	20	-3	25	-199	-333	-160	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	35	47	2,087	2,589	2,910	3,693	4,313	4,802
Imports of Goods	106	342	2,668	3,269	3,928	4,749	5,526	6,178
Trade Balance	-71	-295	-581	-681	-1,018	-1,056	-1,213	-1,375
Agriculture	26	19	258	179	350	401	461	527
Textiles & Garments	-11	-18	827	1,082	1,173	1,409	1,510	1,651
Oil & Gas	-4	-50	-428	-610	-842	-1,176	-1,391	-1,527
Other Goods	-82	-246	-1,239	-1,332	-1,698	-1,690	-1,793	-2,026
Balance of Services	-2	-27	114	291	471	506	648	862
Transportation	-1	-8	-157	-194	-233	-269	-309	-354
Travel (Tourism)	1	3	353	556	743	841	1,015	1,109
Others	-2	-21	-82	-72	-38	-65	-59	108
Balance of Incomes	-4	0.4	-179	-221	-254	-290	-351	-368
Current Transfers (net)	42	9	480	497	535	764	748	760
Private Transfers	0	3	153	176	209	315	332	334
Government Transfers	42	6	326	321	326	449	416	426
Current Accounts(excluding official transfer)	-77	-318	-493	-435	-591	-525	-585	-547
Current Accounts & Capital Transfer	-35	-312	-167	-115	-265	-76	-169	-121
Financial Accounts	0	162	244	219	335	321	358	373
Official Loans	0	130	149	154	144	120	152	158
Foreign Direct Investment	0	0	141	279	381	408	447	435
Others (net)	0	32	-46	-214	-190	-206	-51	-52
Change in Foreign Reserves	-35	-150	77	105	70	246	190	252

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	8,896	10,612
Foreign Assets	4	18	4,741	5,482	6,142	7,650	9,320	11,048
Foreign Liabilities	0	-15	-714	-685	-667	-426	-425	-437
Net Domestic Assets	3	58	-698	-467	-450	-282	1,260	3,488
Domestic Credit	3	59	1,209	1,608	1,972	2,676	4,627	7,270
Net Claims on Government	1	41	-128	-209	-421	-953	-1,093	-1,072
Claims on Government	1	42	360	360	327	287	307	328
Deposits of Government	0	-1	-488	-569	-748	-1,240	-1,400	-1,400
State Enterprises	0	13	0	0	0	2	2	2
Private Sector	2	5	1,337	1,817	2,394	3,628	5,718	8,340
Other Items (net)	0	-1	-1,907	-2,075	-2,423	-2,959	-3,367	-3,782
Total Liquidity	7	61	3,329	4,329	5,025	6,942	10,155	14,100
Narrow Money	5	61	937	1,153	1,323	1,658	1,932	2,269
Currency outside Banks	3	46	908	1,115	1,282	1,600	1,859	2,178
Demand Deposits	3	15	29	38	41	58	73	91
Quasi-Money	2	0	2,391	3,176	3,702	5,285	8,223	11,831
Times and Savings Deposits	2	0	82	97	113	89	107	128
Foreign Currency Deposits	0	0	2,310	3,079	3,589	5,196	8,116	11,703

Source: 1960-2006, *EIC and NBC*. 2007-2008, *EIC model projection*.

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

	1960	1990	2003	2004	2005	2006	2007	2008
Total Investment	80	94	871	979	1,206	1,419	1,588	1,763
Public investment	37	13	295	297	297	370	390	454
Domestic financed	6	13	71	71	75	85	90	118
Foreign financed	31	0	224	226	222	285	300	336
Private investment	43	81	576	682	909	1,048	1,198	1,310
Domestic financed	43	49	435	403	528	641	751	874
Foreign financed	0	32	141	279	381	408	447	435
Total Domestic financed	48	62	506	474	603	726	841	992
Total Foreign financed	31	32	365	505	603	693	747	771
Agriculture Products	14	25	42	39	53	57	61	65
Equipment	0	17	272	299	357	389	328	255
Construction	65	51	557	641	797	972	1,199	1,443
Total Saving	80	94	871	979	1,206	1,419	1,588	1,763
National saving	2	-225	377	544	615	894	1,004	1,216
Government	-22	-167	37	84	124	71	115	95
Non Government	24	-58	340	460	491	823	889	1,121
Foreign saving	77	318	493	435	591	525	585	547
Grants	42	6	326	321	326	449	416	426
Non Grants	35	312	167	115	265	76	169	121

Source: 1960-2006, *EIC and NIS*. 2007-2008, *EIC model projection*.

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

	1960	1990	2003	2004	2005	2006	2007	2008
Agriculture	302	764	1,519	1,600	1,963	2,231	2,430	2,620
Paddy	126	163	349	346	517	551	584	622
Other Crops	80	156	327	379	469	550	626	696
Livestock	26	102	224	236	293	336	381	424
Fishery	22	327	433	437	462	527	557	583
Rubber & Forestry	47	17	185	202	222	267	282	295
Industry	89	170	1,137	1,339	1,542	1,861	2,155	2,457
Garment	16	18	577	709	772	943	1,060	1,172
Food, Beverage & Tobacco	19	70	123	126	149	162	180	199
Other Manufacturing	16	48	121	138	169	202	231	260
Electricity, Gas & Water	5	6	23	27	30	40	47	55
Construction & Mining	33	28	293	339	422	514	637	771
Services	186	470	2,000	2,377	2,773	3,174	3,684	4,209
Transport & Communication	15	64	314	380	464	526	582	643
Trade	485	584	669	786	906	1,015	1,171	1,332
Hotel & Restaurants	16	3	181	222	273	317	374	436
Other Private Services	-408	-212	735	884	1,016	1,190	1,412	1,639
Public Administration	77	31	102	104	113	126	144	159
Total GDP	577	1,404	4,656	5,315	6,278	7,265	8,269	9,286

Source: 1960-2006, EIC and NIS. 2007-2008, EIC Model Projection.

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

	1960	1990	2003	2004	2005	2006	2007	2008
Agriculture	833	948	1,479	1,465	1,692	1,784	1,850	1,918
Paddy	179	197	372	327	469	474	479	490
Other Crops	289	133	313	342	385	425	460	491
Livestock	64	206	236	245	259	280	301	321
Fishery	219	285	426	418	442	459	462	466
Rubber & Forestry	82	127	133	133	137	146	148	150
Industry	549	221	1,147	1,342	1,516	1,794	1,998	2,209
Garment	104	5	612	764	834	1,003	1,098	1,196
Food, Beverage & Tobacco	121	87	122	115	126	130	138	145
Other Manufacturing	100	55	115	124	144	164	179	192
Electricity, Gas & Water	39	5	21	24	27	35	39	44
Construction & Mining	186	69	277	315	386	462	545	632
Services	1,529	712	1,932	2,208	2,483	2,728	2,996	3,262
Transport & Communication	125	100	308	340	385	402	420	441
Trade	480	561	652	726	794	850	917	988
Hotel & Restaurants	187	37	164	202	247	280	314	352
Other Private Services	142	-25	719	858	969	1,111	1,254	1,389
Public Administration	596	40	88	83	87	86	90	92
Total GDP	2,910	1,881	4,558	5,015	5,690	6,306	6,845	7,389

Source: 1960-2006, *EIC* and *NIS*. 2007-2008, *EIC* model projection.

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

	1960	1990	2003	2004	2005	2006	2007	2008
Private Consumption	220	1,419	3,882	4,554	5,328	6,021	6,853	7,696
Government Expenditure	342	203	245	239	256	252	276	230
Gross Domestic Formation	88	103	1,023	943	1,261	1,561	1,724	1,891
Gross Fixed Capital Formation	80	94	871	979	1,206	1,419	1,588	1,763
Changes in Stock	8	10	152	-36	55	142	136	128
Exports of Goods & Services	37	49	2,635	3,394	4,028	4,989	5,878	6,500
Goods FOB	35	47	2,087	2,589	2,910	3,693	4,313	4,802
Service	2	2	548	805	1,118	1,296	1,565	1,698
Imports of Goods & Services	110	371	3,129	3,815	4,594	5,558	6,462	7,031
Goods FOB	106	342	2,695	3,301	3,947	4,768	5,544	6,195
Service	4	29	434	514	647	790	918	835
GDP	577	1,404	4,656	5,315	6,278	7,265	8,269	9,286

Source: 1960-2006, EIC and NIS. 2007-2008, EIC model projection.

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

	1960	1990	2003	2004	2005	2006	2007	2008
Private Consumption	1,176	1,820	3,898	4,399	4,942	5,362	5,810	6,283
Government Expenditure	1,580	263	239	223	230	219	259	200
Gross Domestic Formation	508	137	1,008	897	1,159	1,376	1,452	1,533
Gross Fixed Capital Formation	461	125	852	936	1,119	1,269	1,355	1,445
Changes in Stock	48	13	156	-39	40	107	97	88
Exports of Goods & Services	202	54	2,712	3,390	3,886	4,625	5,222	5,563
Goods FOB	190	52	2,134	2,568	2,784	3,394	3,794	4,069
Service	12	2	578	822	1,102	1,231	1,429	1,495
Imports of Goods & Services	556	394	3,299	3,894	4,527	5,276	5,897	6,190
Goods FOB	536	363	2,842	3,369	3,889	4,526	5,060	5,454
Service	21	30	457	525	638	750	838	735
GDP	2,910	1,881	4,558	5,015	5,690	6,306	6,845	7,389

Source: 1960-2006, EIC and NIS. 2007-2008, EIC model projection.

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

	1960	1990	2003	2004	2005	2006	2007	2008
Agriculture	1,922	2,962	3,886	3,973	4,061	4,145	4,215	4,275
Paddy	1,522	1,997	2,750	2,814	2,878	2,939	2,991	3,036
Other Crops	234	401	478	491	504	516	527	536
Livestock	65	327	373	382	391	400	408	414
Fishery	74	193	247	248	249	248	247	245
Rubber & Forestry	26	44	37	38	39	41	42	44
Industry	99	218	576	627	691	770	843	910
Garment	14	37	257	294	323	368	409	443
Food, Beverage & Tobacco	24	72	82	79	83	85	88	91
Other Manufacturing	28	50	60	63	69	74	78	82
Electricity, Gas & Water	2	3	7	8	9	10	11	12
Construction & Mining	30	57	170	183	208	233	257	282
Services	299	752	1,039	1,077	1,136	1,192	1,227	1,255
Transport & Communication	28	38	68	72	78	80	82	84
Trade	138	270	354	353	376	400	404	405
Hotel & Restaurants	21	5	68	78	88	95	102	109
Other Private Services	54	133	214	239	259	283	304	322
Public Administration	58	306	335	335	335	335	335	335
Total	2,320	3,932	5,501	5,676	5,888	6,107	6,285	6,440

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

Appendix II

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 5th 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 Ratanakiri, Mondolkiri and Stung Treng and these provinces will become a major economic engine by 2015, focusing on mining, agro-industry and ecotourism.

2007

- **June 14, 2007** – Cambodia and Japan signed an agreement for "liberalization, promotion and protection of investment". 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, the first Joint-Council meeting was 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.
- **June, 2007** Russia offers a preferential treatment of Cambodian garment (except wool) exports to its markets duty free and quota free with subject to a 25% rule of origin conditions. EU requires 45% of rule of origin for Cambodian exports penetrating its markets for duty and quota free status.
- **July 2007**, Sr. Minister of Commerce and GMAC embarked on their 4th lobby trip on **TRADE Act** to Washington DC. Their earlier trips were in 2004-2006. This lobby had not been so successful because there is a momentum to introduce a larger Bill that will provide all LDCs duty free and quota free access to US markets. This is in view of the US commitments to the Doha Round Negotiations of the WTO. This bill is being spearheaded by Congressman Jim Mcdermit who is the father of the AGOA Bill.
- **August 17, 2007, The Insolvency Law** was passed by the Council of Ministers. It is being sent to the National Assembly for debate and adoption.
- Under the ASEAN Harmonized Tariff Nomenclature (AHTN) of ASEAN Free Trade Area, Cambodia tariff lines will be reduced further from a little over 11,000 lines to around 8,500 lines effective from September 1, 2007. The implementation would help reduce the Cambodia's average un-weighted tariff rate from 14.90 percent to 14.38 percent.

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 Sub-committee, 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 to 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 up-to-date version of the UNCTAD-designed Information Technology package for Customs automation and modernization. ASYCUDA funded under the World Bank's Trade TFCP.

2007:

- Export Management Fee reduced from 1% to 0.9% of total export value.
- Law on Secured Transaction was adopted on April 06, 2007 and promulgated on May 24, 2007. This law

aims to promote economic activity through a unified set of rules on securing obligations with collaterals

- **April 25, 2007**, the National Assembly adopted the **Law on Cambodian Standard** and was promulgated by Royal Kram NS/RKM/0607 date June 24, 2007. The law would create quality standards for Cambodian-made products, as well as standards for foreign companies importing goods into Cambodia. The law will permit the Commerce Ministry's Camcontrol department to inspect the quality standard of all goods entering the country's market. The Cambodia Standards Institute will be an arm of the Ministry of Industry, Mines, and Energy, which has already implemented standards for drinking water produced for Cambodia's domestic market.
- **22 June 2007**, Law on Customs was adopted by the National Assembly and promulgated on July 20, 2007
- The Law on Concession was adopted by the National Assembly on **September 10, 2007**. Law details the process by which the government can grant private concessions for state-owned infrastructure fixtures.

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 liter for gasoline and four cents per liter 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)¹.
- 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.

2003

- 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

¹ 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.

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 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 Programmed (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 fiducially risks of public expenditure and financial management, and improving fiducially 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.

2005

- 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 the 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.

2006

- 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 was promulgated. It 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 tax and non tax revenue collected through banking system (both customs and tax departments). In the same time, 29% of customs duties collected through banking system by the end of 2006. 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.

2007

- 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 total government tax revenue (excluded non tax revenues) 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.
- April 2007, Investment risk ratings, by Moody's and Standard & Poor's, put Cambodia's first ever sovereign debt rating: a B-plus (two notches lower than Vietnam).
- Government Prakas in March 7, 2007, Import tax payments in cash are no longer accepted at the port of Phnom Penh and port of Sihanoukville for companies and individuals importing more than \$1,000 worth of goods to Cambodia. Effective April 1 2007, tax paid on goods brought in through the two ports must be paid by check to the National Bank of Cambodia or through an account set up at the NBC.
- Based on the notice # 010 (MEF) June 6, 2006 on the Management of Tax Collection on Unused Land. Pursuant to new article 30 of the Law on Financial Management 2007 promulgated by Royal Kram #NS/RKM/1206/035 dated December 29, 2006 and Prakas # 452 SHV.BrK.PD dated June 6, 2007 on amendment to the prakas on Tax Collection on Unused Land, the MEF wishes to inform owners of unused land at provinces-municipalities and Phnom Penh as following:
 1. The unused land located in provinces/municipalities shall be subject to tax on unused land
 2. This tax shall be paid in accordance with the tax rate of 2% on the tax base assessed by the Land Appraisal Committee based on market prices at each municipality and areas to be evaluated in accordance with price per m² for each year.
 3. Each owner of unused land shall be required to apply tax declaration of his land and should he fail to do so would be subject to be fined by additional taxation equivalent to 10%, 25%, and 40% of

the amount of unpaid tax plus 2% interest rate for each month

- February 9, 2007, the Council of Ministers (RGC) approved the Financial Sector Development Strategy (Financial Blue Print) 2006-2015 to further strengthen the banking system in Cambodia.
- On April 30, 2007 the National Assembly adopted the Law on Combating Money Laundering and Terrorist Financing.
- Law on the Issuance and Trading Non government Securities was passed by the National Assembly on September 12, 2007. Law will set the ground rules for the proposed Cambodian Securities Market and establish the body that will regulate it. Cambodia is planning to introduce its bond markets (Securities Market) by 2009.

Sources: *Various government reports.*

Box A2.4: Cambodia Key Reforms in Public Administrative, Civil Servant, (2001-2007)

2001:

- October 2001, the Government approved the remuneration policies which aim at rationalizing, motivating and retaining qualified civil servants.
- The Government introduced Human Resource Management Information System.
- The Base Salary and the Allowances of Civil Servant was issued by Royal Decree on December 2001.

2002:

- As a part of pay reform, the new remuneration and classification system was introduced in 2002.
- Pay reforms increased average 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 manager and technical staff in such areas as policy analysis, financial management and personnel management.

2004:

- Public Administrative Reform became one of the four core reforms in the “Rectangular Strategy” of the Royal Government of Cambodia (RGC) in its 3rd mandate on July 2004.
- The Council of Administrative Reform (CAR) carried out six studies in order to rationalize the civil service: (1) improving public service delivery, (2) benchmarking for labor market, (3) reviewing operation, (4) enhancing remuneration to support performance, (5) enhancing employment to support service delivery, and (6) strengthening the management of the civil service work force.
- National Program for Administrative Reform (NPAR) was drafted in August 2004. It is a competent and transparent public administration able to deliver high quality services to the people of Cambodia.
- RGC increased index value of civil servant salary from 300 CR to 345 CR under sub-decree dated by 15 January 2005.

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 seminar awareness were conducted aiming at capacity building. As result the first promotion of management development program (MDP) and professional development program (PDP) which are parts of the Economic and Public Sector Capacity Building Project (EPSCB) were completed.
- In early 2005, index value of civil servant salary was increased from 300 CR up to 345 CR. In August 2005, 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 Ministry of Economic and Finance (MEF) have agreed to establish the PMG/MBPI (Merit-Based Pay Initiative) to cover an initial 300 centrally located civil servants working on high priority Public Financial Management (PFM) reform activities.

2006:

- A strategy for phasing out salary supplementation practices has been prepared through a collaborative

process within the Technical Working Group (TWG) of Public Administrative Reform (PAR) based on sub-decree No 98 of 2005. Its key achievements in 2006 are as followed: implementing of the approved sectoral action plans, establishing Priority Mission Group (PMGs) and PMG/Merit based pay initiatives (PMG/MBIs) 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 staffs have been proposed of an MBPI and this proposal has been 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 condition in the civil service.
- Design and Implement HRM policy and action plan to improve merit and performance management by introducing HRM guide and further developing HRM Information Systems (HRMIS) for the civil service.
- Enhance service delivery through developing a one window offices (OWOs) policy, legal framework and implementation plan. Five OWOs have been established across Cambodia.

2007:

- A meritocratic system has been 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 percent per year. The average salary of civil servants has now reached approximately US\$46 per month.
- The salary of civil servants will be increase by 25% since July 2007 and start from 2008, the salary of civil servant, police and military personnel will be increased by 20% a year. Since January 2002 to July 2007, civil servants' remuneration raised to US\$51.3 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:

- Land Law was adopted by the National Assembly on July 20, 2001 and promulgated on August 30, 2001. It provided legal protection to establish the security of land tenure and also a fundamental basis for the reduction of land disputes.
- During 2001, government has also issued a note about stopping illegal possession, and a set of ministerial instruction (Prakas) regarding service fees for land registration.
- The draft of forestry law contains 18 chapters and 109 articles was approved by the Council of Ministers on July 20, 2001 and officially submitted to the National Assembly dated 17 August, 2001.
- The Prakas No 5721 was issued to suspend all logging activities by the government of Cambodia in December 13, 2001.
- The Community Fisheries Development Office was established by Prakas No 084 of MAFF in January 21, 2001.

2002:

- To accompany implementation of the Land Law, and provide several guidance in the land sector, the Council of Land Policy approved an Interim Land Policy Framework document in May 2002.
- Ministry of Land Management, Urban Planning and Construction (MLMUPC) had prepared several sub-decrees to enable the effective implementation of the land law. Those sub-decrees were adopted by the Government of Cambodia in 2002, included 1) Sub-decree on the Organization and function of the Cadastral Commission, 2) Sub-decree on Systematic Registration, and 3) Sub-decree on Case-By-Case Registration.
- Under supported by the World Bank, MLMUPC created Land Management and Administrative Project which was made effective in June 2002.
- The National Policy for Forestry was issued by the Government on July 26, 2002.
- Forestry Law was adopted by the National Assembly on July 30, 2002 and promulgated on August 31, 2002.

2003:

- The Inland Fisheries Research and Development Institute (IFReDI) was inaugurated on February 18, 2003. The institute was established in order to provide scientific information through research and development capacity for freshwater fisheries in Cambodia.
- Sub-decree on Social Land Concession was issued on March 07, 2003.
- Sub-decree on Forest Community Management was adopted on December 15, 2003.
- Council of Land Policy was established as focal point to facilitate the formulation of strategy and policy in land management.
- Department of Forestry was renamed the Forest Authority by sub-decree No. 64 dated September 11, 2003 with a horizontal management structure nationwide to undertake policy reform of the forest sector.

2004:

- RGC disclosed the location and legal status and process for termination of mining concessions, Military Development Zones, economic land concession and other development arrangements situated on forest land or in protected areas and inconsistent with law governing management of these areas.
- Prime Minister's Order No.01 on prevention, repression, and elimination of forest clearing, firing, bulldozing, and grabbing was issued on June 09, 2004.
- The Council for Land Policy, in collaboration with development partners was developing Land Allocation for Social and Economic Development (LASED).
- National committees and sub-national committees at the provincial level were established to implement

the Order No.01.

2005:

- Sub-decree No. 53 on establishment, classification, and Registration of Permanent Forest Estates issued on April 01, 2005
- Decision No. 28 on establishment of Control and Evaluation Committee to Stop Encroachment on Inundated Sea Forests, Land Leveling and Land Filling Along Sea Side issued on August 14, 2005.
- Sub-decree on State Land Management, sub-decree on Economic Land Concession, and sub-decree on Managing State Owned Land were passed by Council of Minister in late 2005.
- Royal Decree No. 0505/240 on the Establishment of Fishing Community was issued on May 29, 2005.
- Sub-Decree No. 80 on management of Fishing Community was issued on June 10, 2005.
- The Community Fisheries Sub-Decree was approved by the Council of Ministers on 20 May 2005

2006:

- A Royal Decree on the Community Fisheries Establishment was issued in May 2005 followed by an issuance of a sub-decree on the Community Fisheries Management in June 2006
- Fishery Law was adopted by the National Assembly on March 30, 2006 and promulgated in May 21, 2006.
- A sub-decree on the transformation of the Department of Fishery (DoF) into Fishery Administration was signed in August 2006.
- The National Community Forestry Program Strategic Paper was issued in May 2006, stipulating the Government's Plan to offer formal recognition to the already existing Community Forestry sites of 274 and further creating an additional 200 to 400 formally recognized Community Forestry sites.
- Information on the Economic Land Concession was posted available to the public through MAFF website and a technical secretariat was established by decision No 27 dated June 30, 2006.
- A Prime Minister's Order on the Prevention of Deforestation was issued in May 2006.
- A District State Land Working Group was established to help the provincial committee in State Land Identification and Mapping.
- Regarding the issue of land grabbing, a Prime Minister's Order was issued on the Prevention of Deforestation for Land Ownership in May 2006.
- A Land Dispute Agency was established with a Royal Decree dated February 26, 2006 with the members from both the Government and the opposition party.

2007:

- Marine conservation, a Ten-Year Action Plan for Coral Reefs and Sea-Grass has recently been adopted by Ministry of Agriculture, Fisheries and Forestry.
- Law on Water Resource Management was adopted on May 22, 2007 and promulgated on June 29, 2007.
- Agricultural Sector Strategic Development Plan, 2006-2010 is presented by MAFF.
- Prakas on Guideline of Fisheries Community was approved on July 13.

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

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